A
H I S T O R Y
O F T H E F E D E R A L I N C O M E T A X
I N C A N A D A

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The undersigned hereby certify that they have read and recommend to the School of Graduate Studies for acceptance, a thesis entitled

" A History of the Federal Income Tax in Canada"

submitted by Paul H a l j a n

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A HISTORY OF THE FEDERAL INCOME TAX IN CANADA

A DISSERTATION
SUBMITTED TO THE SCHOOL OF GRADUATE STUDIES
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by

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A SYNOPSIS

This study surveys the development of Dominion income taxation against a broad social, economic and fiscal background.

Chapter I furnishes a brief review of the main currents of federal fiscal policy since the establishment of the Dominion of Canada in 1867 up to the present time. Emphasis is put on the gradual change in the structure of the Dominion revenue system which in time developed from a rather simple one based on indirect taxation into a modern and effective arm of the government.

Chapter II is devoted to the very beginnings of direct taxation on the federal level which are coupled with the rise of the agrarian class. The British and American influence is recognized. Direct taxation and income tax became a political issue between progressive farmers and the manufacturing class prior to World War I. During the war, the farmers, with the help of war finance, succeeded in compelling the Conservative government to accept their proposals.

Chapter III traces the development and growth of the income tax during the inter-war period. An account is given of the renewed opposition to the income tax, of Dominion-provincial frictions over the distribution of revenue fields, and of the role of income taxation during the Great Depression.

Chapter IV covers the events influencing the development of income tax during World War II. The fundamental social

changes brought about by the economic crisis of the thirties, followed by the rapid economic growth of the forties, prepared Canada for the break with the past which occurred around the beginning of the past decade. This new departure was already discernible during World War II, after the Dominion government decided to put the income tax into full operation for war purposes. The tax helped to finance war costs and to check the upsurge of the domestic price level.

Chapter V gives but a brief account of postwar development in the income tax field. Reference is made to the Dominion-provincial tax agreements, and the movement for income tax reform is briefly described. No attempt is made to evaluate the events nor to consider eventual economic affects of the tax upon the national income.

Chapter VI is devoted to some specific aspects of Canadian income taxation, in particular to the Canadian concept of income, personal exemptions, tax rates and tax administration.

PREFACE

The history of Dominion income taxation has attracted relatively scanty interest from either historians or economists. Save the chapter on background and development of corporate income tax in Dr. Petrie's treatise The Taxation of Corporate Income in Canada, little has been written on the subject. Therefore this thesis is an incursion into a *terra nova* in public finance undertaken by a recent newcomer to Canada.

The thesis is hardly more than an introduction to the whole topic. As my research work progressed I realized more and more that the subject deserved more comprehensive treatment than a master's thesis could provide. For this purpose, I have concentrated my attention more on the early period, the very beginnings of the agrarian income tax movement, and on the developments during the twenties and thirties.

In preparation of this thesis I was fortunate to have very helpful assistance from the Department of Finance whose library I was permitted to use freely, from the Library of Parliament, from the Public Archives, and from the Dominion Bureau of Statistics, which I gratefully acknowledge. My particular gratitude goes to the Canadian Tax Foundation for the award of the M.L. Gordon Junior Fellowship for the current academic year and the assistance attached to it, without which I could hardly have been able to undertake a study

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My final word of thanks belongs to the people and the government of Canada. Without the privilege of sharing their freedom and their institutions this work would never have come into existence.

Edmonton, March 31, 1954. P.H.

C O N T E N T S

L I S T O F T A B L E S

L I S T   O F   C H A R T S

CHAPTER I.

THE CHANGING PATTERN OF FEDERAL PUBLIC FINANCE

INTRODUCTION

Canada's participation in the last two World Wars had a profound impact upon her economy and institutions. The federal government, faced during World War I with the serious risk of financing the avalanche of war expenditures and unable to borrow extensively abroad was compelled to revert to its domestic sources. As a consequence, the government had to broaden the revenue system, to increase its yield, and to start borrowing on the domestic money market. When the war ended the federal government was collecting a substantial revenue from the income tax field, and about $2.1 billion of its funded direct debt was payable in Canada.[1]

This situation represented a revolutionary change in the government's finances. Prior to the war, customs and excise duties comprised practically the entire government's tax revenue and the occasional loans on the domestic money market never exceeded the amount of $5 millions. In 1914 the Canadian public held a little more than one-tenth of one per cent of the entire Dominion debt.[2] But the most important result of

1. Royal Commission on Dominion-Provincial Relations, Report, I, p. 103.

2. Buck, A.E., Financing Canadian Government, Chicago, 1939, p. 172.

those war changes was that Canada discovered her own economic power.

The enactment of the Business Profit Tax Act in 1916 and the Income War Tax Act in the subsequent year marked a turning point in the development of the federal revenue system. It initiated the drift from indirect towards direct taxation which, though somewhat retarded during the inter-war period, gained momentum in World War II, and has not yet terminated. Because of its constitutional aspects, the sphere of direct taxation became a major cause of Dominion-provincial frictions, the more so since the twenties and thirties were the lean years of economic activity bringing along the serious problem of mass unemployment. Provincial governments, constitutionally responsible for social welfare, and restricted to direct taxation found it very difficult to raise enough tax revenue needed for fulfilment of their responsibilities.

As will be seen, the federal income tax, the history of which is the subject of our study, affected Canadian public finance very materially. Therefore it seems to be worthwhile to devote some space to the preceding history of federal public finance which, we expect, will enable us to grasp better the profundity of its influence upon the Canadian economy and its institutions.

Revenue System at Confederation

The establishment of the Dominion of Canada was largely an

outcome of political and economic exigencies the gravity of which far surpassed the limited abilities of the young agricultural economies of the British North American colonies. The political and economic vacuum created in British North America by the decline of British imperial policy and accentuated by expansionary ambitions of United States called for an expeditious decision were the provinces to remain under the British rule. The pressure of circumstances and, later on, of the Colonial Office in London, made the Fathers of Confederation produce a compromise which the Imperial Parliament immediately embodied into the British North America Act of 1867.

The Canadian Constitution in its original form bears an indelible stamp of its period and environment. Conceived and elaborated in the time when Gladstonian eloquence and J.S. Mill's political and economic philosophy dominated the British mind it could not escape the influence of these last two great liberals. Curiously enough, the popular liberal slogan "the less government the better", as applied to the Canadian constitution, favoured the centralization of power in hands of the central government restricting the former provincial governments to local affairs and making them mere safeguards of minority rights.[3] If the allocation of

3. Cf. Creighton, D.G., British North America at Confederation, Royal Commission on Dominion-Provincial Relations, Appendix 2, Ottawa, 1939.

responsibilities between the federal and provincial authorities might seem ambiguous in Sections 91 and 92 of the B.N.A. Act, the distribution of taxing powers and fiscal arrangements at Confederation expose quite clearly the idea of federation which the founding fathers intended to establish.

Under the terms of the B.N.A. Act the federal government was given unlimited authority of raising money by any mode or system of taxation, whereas the provinces were restricted to sharing the field of direct taxation within their prospective boundaries. In fact, the second paragraph of Section 92 of the B.N.A. Act contains a triple limit upon the provincial taxing authority: the limit in mode, in territorial extent, and in purpose. At the Quebec Conference, it was generally assumed that direct taxation would play but a minor role in fiscal revenues of both provincial and federal governments, and that a tax upon incomes was not feasible under the economic and political conditions of that time. The representatives from the Maritimes and Lower Canada therefore argued quite effectively that even the limited governmental responsibilities of the provinces would become illusory unless they were given revenue sources adequate to meet their responsibilities. The Conference weighed two possible solutions: either extending the provincial tax authority to some kind of indirect taxes or assuring provinces a revenue from the federal treasury in the form of annual grants. Their choice of the latter, as instituted by Section 118 of the B.N.A. Act, was of

historical importance.

If the allocation of tax powers decidedly favoured the fiscal supremacy of federal government, the adoption of the device of federal annual subsidies for support of provincial administration did solidify it.[4] Although it may be argued that the founding fathers adopted the idea of federal assistance as a lesser evil, yet the truth remains that they were meticulously careful in avoiding any curtailment of federal fiscal authority. In other words, the task of the time was to establish a federal authority strong enough to fulfill the great expectations rather than to devise a subtle federal scheme with all possible checks and counterbalances between the two levels of governments. Thus the founding fathers vested the Dominion with fiscal authority that was nothing short of fiscal sovereignty.

Indeed, such wide fiscal powers were conceived in view of the vast and heavy responsibilities imposed upon the Dominion. It was to assume the sole responsibility for defence, to further the economic development of the country, and it was to relieve the provinces of their burden of public debt totalling $88.6 millions. The federal government was pledged to

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4. The subsidies' provisions represent an integral part of the Canadian constitutional scheme. They interpret the broad lineaments of Sections 91 and 92, and in the light of this interpretation the Canadian constitution moves closer to the federal - if not unitary - scheme than to a confederation as some are inclined to believe.

improve the existing transport system, to build the Intercolonial Railway, and to open the western frontier. Each of these undertakings, taken by itself, would call for a full effort of the Canadian economy over a considerable number of years.

The Dominion left unexplored the broad base for its revenue system for over half of a century. From the very outset of its functioning the federal government followed fairly closely the revenue pattern set up by the old provincial governments. In fact, during the first years of Confederation the Canadian taxpayer was paying virtually the same amount of taxes as he did prior to its establishment, although he was supporting two separate governments. The smooth transition from the old provincial to the new Dominion tax administration was mainly due to the foresight and statesmanship of Alexander Tilloch Galt (later Sir), the last finance minister of the Province of Canada. An expert of calibre in fiscal matters, he anticipated the possible difficulties that might arise during the early stage of Confederation and endeavoured to eliminate them in advance. In his provincial budget of 1866 Galt effected changes in the most important revenue source - the customs duties - that made the Canadian tariff nearly identical to those employed by the seaboard provinces.[5] This move, originally intended to woo the Maritimes

5. Creighton, <u>op. cit.</u>, p. 74.

into Confederation, not only eliminated the fears of the Maritime provinces, more sensitive to high taxes, but, above all, it spared the Dominion parliament the arduous task of equalization of tax rates which might easily become the first apple of discord among the provincial factions in parliament.

The provincial pre-confederation revenue systems together with the Dominion fiscal structure of the early period exhibit a striking simplicity in composition and restraint in volume. All of them rested upon one chief revenue source, namely, the tariff, that provided the treasuries with 60 to 80 per cent of current revenues. In the fiscal years ended 1866 the customs duties yielded 60 per cent in the Province of Canada, 80 per cent in Nova Scotia, and in New Brunswick 78 per cent of total receipts. Only the Province of Canada levied excise duties and collected $1,889,000, or 16 per cent therefrom. The remaining one-fifth encompassed a variety of non-tax revenues, like proceeds from sales of commodities and services (9 to 12 per cent), public domain (7 to 8 per cent), interest, premium and discount (1 to 4 per cent), and licenses, permits, fees, etc. (1 to 2 per cent). The combined current revenue of the three founding provinces came to $15 million in the same fiscal year, indeed, a mere trifle when compared with the billion dollar provincial revenues of today. The burden of taxation per capita fluctuated around $3.50, whereas the costs of government services per capita were slighly higher,

about $4.65.[6]

The federal fiscal system reflected largely the more advanced revenue pattern of the Province of Canada. Customs duties retained the prominent place among revenue sources, yielding about 64% of total federal revenues during the first seven years. The excise levied upon the manufacture of beer, spirits and tobacco hit the 24% peak in the fiscal year ended 1874, rounding out the share of indirect taxation in the federal budget close to nine-tenths of current income per year. The additional one-tenth was derived from non-tax sources: sales of commodities and services (8%), interest, premium and discount, and public domain. The Dominion derived practically no income from items like licenses, permits, fees, etc. The current revenue of the Dominion stood at $15 million in the first fiscal year, but after the first seven years of functioning it passed the $20 million mark. This 25% increase in revenues was mainly due to the territorial expansion and buoyant economic activity which accompanied the first steps of Confederation.[7]

The conspicuous absence of any direct tax in both provincial and federal revenue schemes may be justified only in view of the simple economic conditions prevailing in Canada at the

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6. See <u>ibid</u>., p. 62 ff.

7. <u>Ibid</u>., p. 94.

time of union. The population of 3 1/2 million, scattered over a vast territory, were grouped in tiny settlements connected by primitive or no transport facilities. Municipal organization, unknown in the Maritimes, was in its infancy in Upper and Lower Canada. Agriculture employed over half of the whole population, while manufacturing was just established in sectors that required but little capital investment and little specialization. Woollen mills, clothing and furniture and shoe factories, breweries and distilleries orienting their production to the local market enjoyed more a transport than a tariff protection. Indirect taxation was well-fitted for such an economic set-up. It represented a simple and inexpensive mode of collecting revenue. Concentrated virtually to ports of entry and places of production it required a small administrative machinery to reach every taxpayer. Furthermore, the costs of government services were not high and thus the government was free to explore fully the tax-sources that were politically most expedient.

The Tariff Era of Federal Public Finance.

The extensive capital investment program pursued by the Dominion government from the beginning partially generated the first boom that was considered as a lucky omen of Confederation. The substantial increase in public debt during the first seven years reflected the volume of foreign capital that

entered into Canada mostly in the form of goods, and through the tariff favourably influenced federal revenues. The interposing of the American market between the British investor and Canadian creditor accentuated the revenue effect of British investment. Most of the goods, paid for by British funds, originated in United States and were subject to higher tariff rates. The close interdependence between borrowing abroad and federal revenue produced the peculiar cyclical movements that characterize the first thirty years of Canadian economy.

The construction of the Intercolonial Railway together with improvements of the St. Lawrence canal system stimulated the economic activity which created a mood of general optimism. The induced increase in the volume of foreign of trade, especially in imports, doubled the customs revenue within seven years without any significant increase in tariff rates. The federal government, encouraged by this trend, pursued a strong national policy and was ready to undertake the costly task of opening the West. In 1870 it acquired from the Hudson's Bay Company the North-Western territory and immediately created the fifth province of Manitoba. In the subsequent year, British Columbia joined the Dominion on very generous terms which included the federal commitment of construction of a Pacific railway, and the dream of a realm from sea to sea became a reality sooner than one could have

expected. In 1873 the Province of Prince Edward Island found her way into the federal fold, where she expected to be relieved from public debt incurred in financing her railway development. By the same year the Dominion completed its first obligations: the Intercolonial Railway and a deepened St. Lawrence seaway had been put into use.

Unfortunately, the end of the first spur of economic development coincided with the economic depression abroad, consequences of which were soon felt in Canada. The initial optimism was dissipated entirely toward the end of the seventies. Falling price levels at home and abroad brought about a decrease in foreign trade, and as a further consequence, a decrease in federal revenues. Galt's tariff based on ad valorem rates proved to be failure as a secure source of government revenues. Although Francis Hincks, the Minister of Finance in MacDonald's cabinet raised the spectre of direct taxation as early as 1870, no attempt was made to widen the federal tax base. Instead, the seventies marked an extensive debate on tariff policy which finally resulted in defeat of the Liberal government of Alexander Mackenzie in 1878, and in adopting of the Conservatives' program known as "National Policy".

The four years preceding the election in 1878 represented the formative period of fiscal and commercial policy that dominated in Canada until the depression of 1930. Galt's

doctrine of a revenue tariff with incidental protection as espoused in his budget speech in 1866 was not seriously challenged during the years of prosperity. Though the refusal of Washington to renew the reciprocity treaty in 1869 aroused random demands for a retaliatory tariff, the feeling across the country was still opposed to high customs duties. Even the moderate increase (2 1/2%) in the general tariff enacted under serious revenue exigencies in 1874 elicited considerable antagonism. But, by this time, the worsening economic conditions began converting public attitudes. The case of protectionism was taken up by Ontario manufacturers who established in the same year the Manufacturers' Association of Ontario for the purpose "to secure by all legitimate means the aid of both the public opinion and governmental policy in favour of the development of home industry, and the promotion of Canadian manufacturing enterprise".[8] The movement gained momentum by political action. MacDonald's Conservative party, whether from political opportunism or from a serious concern with the economic situation or both, made protectionism a political issue of paramount importance in the election campaign of 1878. Apart from dramatization and rhetoric that chaperoned the presentation of National Policy to the electorate, it was economically sound and politically

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8. Clark, S.D., Canadian Manufacturers' Association, Toronto, p. 5.

well timed.

In the short run, it offered a remedy for fiscal exigencies of the federal treasury, and in the long run it substantiated the cause of Confederation and its aims. Had Canada followed either of reciprocity or "Zollverein", foreign interests may have reaped most of the fruits from Canadian soil. There was a bit of truth in Sir Leonard Tilley's remark made in his budget speech in 1879: "The time has arrived when we are to decide whether we will simply be hewers of wood and drawers of water".[9]

The "National Policy" programme of the Conservatives aimed at building Canada as a balanced economic unit by means of an extensive railway system and a protective tariff, oriented to European markets rather than to the United States. Sir Leonard Tilley replaced the old ad valorem principle by a scheme of specific rates high enough as to protect domestic production. The upward revision of tariff rates improved the financial position of the treasury. It checked, for the time being, at least, the shrinking customs revenue and stabilized the excise yield. By 1883 the treasury enjoyed a substantial surplus on current account. However, the public investment and favorable terms of trade played an important role in this

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9. McDiarmid, O.J., Commercial Policy in the Canadian Economy, Cambridge, Mass., 1946, p. 181. The quotation is from Debates of the House of Commons, 1878, p. 429.

second upswing as well. After completing the Pacific railway project the government, apprehensive of rising debt charges, restricted its borrowing abroad and cut the developmental programme to a minimum.

The second spell of recess that followed was even more serious than the first one, and furthermore, it lasted longer. Tariff revenue fell sharply again despite frequent increases in tariff rates while expenditures moved slowly upward. Recurrent deficits became unavoidable and discouraging. The discontinuance of a domestic investment programme limited the possibilities of recovery to external events, which did not come until the end of the century. But, when the delayed recovery arrived, Canada had a new government, a new leader, and a new period of prosperity ahead.

The wheat boom easily solved many pressing problems of the federal government. With rising revenue, Laurier's ministry possessed the means to realize the plans of the founding fathers and to fulfill the expectations of the Dominion. After the Liberals stepped into office, their political platform accepted at the Ottawa Convention in 1893 aroused some fear that they would dismantle the protective walls of National Policy.[10] This was soon dispelled. The government decided to preserve the basic principles of National Policy and confined themselves to eliminating what they

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10. Ibid., p. 203.

had labelled as monopoly and class favoritism in the election campaign. So for fifteen years of Liberal administration the Canadian economy prospered and expanded at a tremendous rate under the roof of the National Policy and state paternalism.

The development of the West attracted huge quantities of foreign capital, mostly from the London money market, which entering Canada in the form of goods, induced a rise of tariff revenue to dimensions hitherto unknown. Between 1896 and 1913 income from customs duties jumped from $20 million up to $111 million while excise revenue rose from $8 million to $22 million.[11] The government, encouraged by recurring surpluses, launched a developmental program that has hardly been surpassed in its relative size. The settlement of the Prairie Provinces, construction of railways, and investment in public domain occupied first place on the expenditure list. During the first decade of this century the Dominion expended about one and a half times more on capital account than it did during the preceding thirty years. Gross direct debt increased by $150 million reaching the level of $512 million.[12] Aside from development the more significant items on the expenditure side were defence and statutory

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11. Canada Year Book, 1940.

12. Ibidem.

subsidies. The latter was due to new fiscal arrangements between the Dominion and provinces agreed upon in 1907, and to establishment of the provinces of Alberta and Saskatchewan in 1905.

The prominence of the tariff as the chief revenue source remained solid. It provided, together with excise revenue, 80 to 85 per cent of total revenue receipts, despite some downward revision of rates. However, by this time, a new opposition to the protective tariff was gaining momentum in the West, where farmers, never in love with government high tariff policy, were rapidly becoming a force in Canadian politics. The Western farmers' associations at their conventions held early in 1910, demanded a removal of duties on farm implements and supported a reciprocity treaty with the United States. Later on, they started pressing for the introduction of an income tax that should replace customs duties in the federal revenue structure. They found allies in the Liberal Party, and with the help of war events that followed, finally succeeded. But they failed to secure their main objective, tariff reductions.

During the first fifty years of its existence the federal system rested almost exclusively on indirect taxation. The simple combination of customs and excise duties bequested to the Dominion by the old provinces supplied the federal treasury with 80 to 90 per cent of its current receipts

throughout the whole period with relatively great success. Inasmuch as the chief source of revenue came from tariffs, the revenue yield largely depended upon the cyclical movements of foreign trade. The introduction of National Policy might have proved successful in checking the cycle if the government had adopted a higher level of its investment. The first years of National Policy indicate such a possibility. Federal revenues had shown a remarkable upward trend during the wheat boom, but their base failed to expand.

Several factors accounted for the reluctance of the government to introduce an income tax. Firstly, the judicial interpretation of the B.N.A. Act impaired the exclusive authority of the federal government; secondly, the provincial governments started imposing direct taxes as early as 1873; and thirdly, during the wheat boom, customs and excise duties provided the treasury with a satisfactory inflow of income, which made a new tax unnecessary. Furthermore, federal expenditures were dominated by a single factor, economic development, which could be easily adjusted to the size of revenues. Prior to World War I the Dominion was relieved from excessive defence spending and the social services did not require any substantial outlays. Once those items became a necessity, the readjustment of the revenue system was unavoidable.

Direct Taxation in Federal Revenue System

The year of 1911 closed the tariff era of federal public finance. The federal elections of that year revived the old issue of National Policy versus Reciprocity, and the final results brought defeat to Laurier's Liberal government. However, with Sir Wilfred had gone a half century of Dominion history. When the flag-waving quieted down and the Conservatives assumed power, world events turned upside-down many plans and many expectations. Within two years a war broke out that did not leave out the Canadian community. To the detriment of Canada the new government was not prepared for such a serious assignment. Fifteen years of opposition did not augment their administrative experience, and, as the elections indicated, they were looking back to the eighties of the past century rather than ahead. The new Minister of Finance, W. Thomas White (later Sir) was homo novus in politics and in parliament as well. Furthermore, Canada had not been involved in a conflict for over a century and lacked experts to call upon for advice. Perhaps, here lies the explanation of maladjustments that had roots in the war economy and that exerted an adverse influence long after the war was over.

The War Cabinet of Sir R.L. Borden employed chiefly three instruments in financing the mounting war expenditures, borrowing, taxation and monetary expansion.[13] One of their first

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13. See Chapter II.

moves was a substantial revision of tariffs. The rates were increased by 5% on the British preference and by 7 1/2% on the immediate and general tariff, while the list of dutiable goods was expanded. Loans to finance war expenditures were contracted in the London and New York money markets. But in 1915, Britain had closed her money markets which compelled the Dominion government to revert to its domestic sources. Following the marked success of the first domestic loan in the same year, the government borrowed about $1,200 million at home. In the taxation field the government moved slowly and with much apprehension. In 1915 new internal taxes were imposed on bank circulation, telegrams, cablegrams, railway tickets, postal cheques, post cards, etc., and on the income of certain insurance, loan, and trust companies. In the subsequent year the business profits war tax was introduced, and by the end of 1917 an income tax was in force.

Both direct taxes employed very moderate tax rates, together with large exemption clauses, thus making their anti-inflationary effects negligible. However, the very fact of inception of direct taxation on the federal level surpassed all other fiscal developments. It opened a new period of fiscal expansion and prepared the Dominion for the fateful events that were to follow in a distance of twenty years.

The aftermath of the war necessitated a further broadening of the federal financial tax base. Under the pressure of

large deficits Sir Henry Drayton, the Minister of Finance in the Union government, ushered into the federal revenue system a novel indirect tax, known as the general sales tax. The discontinuance of the business profits war tax in the following year has modified the federal tax system for peace-time purposes.

Government expenditures rose during the war period to unprecedented heights. Net debt charges were raised to the second power between 1913 and 1921, exceeding the total ordinary expenditures of 1913 by $34 million. New expenditures had to be undertaken to defray veterans' pensions and after care. Some items, hitherto unimportant, required substantial outlays, and the higher price and wage level swelled the expenditures on current account to $354 million as against $118 million of 1913. About half of this amount consisted of transfer payments which yielded no immediate services.[14]

The inter-war period left unaffected the federal revenue structure <u>per se</u>. The volume of tax revenue followed the ups and downs of the level of economic activity, altering the relative importance of individual tax sources.

The numerous amendments to tax acts need not be discussed

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14. Cf. Royal Commission on Dominion-Provincial Relations, <u>Report</u>, <u>I</u>, p. 106, Table 23.

here. However, there have developed two movements that, later on, influenced federal taxation. The first movement was strictly an affair of Canadian federalism. The precarious balance between responsibilities and tax powers of the Dominion and provinces established by the founding fathers had been impaired by judicial interpretations of the B.N.A. Act. Enlarged responsibilities of provincial governments were not paralleled with a similar development in the allocation of revenues. It was, therefore, one of the main purposes of the Royal Commission on Dominion-Provincial Relations to survey the whole field of allocation of responsibilities and revenue sources between the two levels of government and to propose solutions. Curiously enough, the recommendations of the Rowell-Sirois Commission do not differ much from the decisions made by the founding fathers some seventy years before. In other words, the Commission recommended a restitution of the original principles of the Canadian federation. The second movement that originated in the serious economic consequences of the world-wide depression led to a reconsideration of the role of public finance in economic policy. Incepted by Sir John Maynard Keynes during the thirties, the theory of the relation of fiscal policy to the working of national economy has made great strides, particularly, during the past war and thereafter. The pervasiveness of this theory in Canadian public

finance is more than striking.

From the very outset of World War II the national government embarked on a strong fiscal policy with a firm determination to curb all the adverse effects which a war economy always brings with it. It relied heavily upon taxation to freeze price and wage fluctuations, to curtail inflation, and thus to eliminate, to the greatest possible degree, the misallocation of resources. The income tax served a twofold purpose. On the one hand, it provided the bulk of war revenue (64% in 1944), and on the other hand, it sterilized the effect of government large-scale war expenditures. Accordingly, the tax rates were raised to a level that was the highest in the world for incomes in the middle brackets.[15] The adoption of a pay-as-you-go policy necessitated over-all increases of tax rates and broadening of the tax system. New taxes on gasoline and other products were levied; the inheritance and gift tax, together with the excess profit tax were introduced to supplement the effects of income taxation. In 1941, the Minister of Finance requested the provinces to vacate the income tax field for the duration of the war and offered them a compensatory payment amounting either to their collections from those fields in the preceding fiscal year or to their debt charges. Provincial governments responded favorably and

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15. Cf. Higgins, B.H., Canada's Financial System in War, National Bureau of Economic Research, New York, 1944, p. 10.

signed the War Rental Tax Agreements in the following year, thus enabling the Dominion to make a full use of income taxation. The bold use of income taxation by the federal government during the war was aptly described by J.R. Beattie as "the backbone of the government's policy".[16]

The fiscal measures adopted during the war were deemed to be extraordinary and temporary provisions, conditioned by special war circumstances. However, before the war ended the government made it plain that it was determined to carry on most of the war legislation, on a lower scale, after the cessation of hostilities. Behind this decision was a fear that there might develop a serious economic slump as an aftermath of war. In 1945 the Dominion-Provincial Conference on Reconstruction convened in Ottawa, but due to strong opposition of the Provinces of Ontario and Quebec to tax agreements it failed to succeed. The partial solution that followed has been a peculiar feature of the Canadian fiscal system up to the present time. Since last year's renewal of tax agreements the Province of Quebec alone has been in opposition to any fiscal arrangements on grounds of constitutional prejudice.

On the whole, the federal fiscal system has undergone

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16. Beattie, J.R., " Canadian War Finance", Industrial Canada, Feb., 1943, p. 43.

a great transformation since World War I. It has been enlarged and deepened. The ushering in of direct taxation into the family of federal taxes brought about a new line of development that has been significant particularly for two effects. On the one hand, the tax actualized the latent constitutional crisis of Canadian federalism, and, in the final end, it contributed to re-affirming the constitutional position of the federal government. On the other hand, the fiscal system was gradually converted into a more productive as well as progressive scheme favoring lower income groups. But the traditional objective of Canadian public finance as inaugurated by the National Policy programme in 1879 has hardly been changed.

In his budget speech on May 18, 1948, D.C. Abbott, the Minister of Finance, restated it as follows:

> "I believe that all parties in this Parliament and most Canadians share the view that the national budget is no longer merely a matter of the government accounts that should be balanced every twelve months on some financial rule of thumb. We view the national budget now as an integral part of the nation's business, influenced by and having influence upon the state of employment, income and prices. I think we should all agree that in times of widespread unemployment and insufficient demand for goods and services our expenditures should be increased in order to support employment and incomes, and that they could and should exceed our revenues under such conditions." 17

17. Debates, Budget Speech, May 18, 1948, p. 4063.

Perhaps, a new terminology, a new colouring, but it was still the same profound determination of the government to serve the country at its best.

CHAPTER II.

THE INCOME WAR TAX ACT

The Case for a Federal Income Tax

During the first fifty years of the Canadian federation the income tax attracted little or no attention from all levels of governments. Although it is true that some provincial and municipal governments adopted some sort of a tax upon incomes, the measures in general were too imperfect and too leniently enforced so that they could hardly be subsumed under the term of an income tax as we understand it today.[1] Reference has been made to the reasons responsible for this attitude, particularly, the nearly universal detestation of direct taxation in Central Canada.

Both national parties were tariff parties, differing more in degree than in principle. It was therefore quite easy for the Canadian Manufacturers' Association, the most influential class organization outside politics and a stalwart of protectionism, to build up for its members from protection a privileged position in the nation. The influence of the association was strong enough to prevent the Liberal Party, which stepped into office after the 1896 elections with a pledge of doing away with the protective tariff, from fulfilling its promises given to the farming

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1. Cf. Vineberg, Solomon, Provincial and Local Taxation in Canada, New York, 1912, p. 63 ff.

electorate. However, the wheat boom changed the social and economic conditions of the country and brought the agrarian class to the fore. It prepared the ground for introducing the income tax into the federal revenue system.

In contrast with the history of income tax in Great Britain where the tax was originated and developed by Chancellors of the Exchequer, in Canada the demand for fiscal reform came from the ordinary taxpayer who had to push his Finance Minister instead of being led by him. Not discounting the influence of war conditions which accelerated the Canadian income tax movement, it may be said that the adoption of a federal income tax measure in 1917 was largely the outcome of the strife between the protectionist manufacturing class and the free trade farmers, an example of shifting the burden of taxation between social classes.

Farmers' Opposition to Tariff Policy

Canadian farmers, after a short honeymoon with National Policy, soon began to realize the adverse impact of the high tariff upon their economies. Discontent, denunciation and opposition were not uncommon among farming groups during the eighties and nineties of the last century. Some presentations submitted to the federal government in this matter by the Dominion Grange and Patrons of Husbandry found a deaf ear in Ottawa. However, the persisting economic stagnation gradually decimated the fighting spirit of the farmers and also

disintegrated their organizations. When the prosperity of post-1896 began, the Canadian farmer was ill-prepared for the coming events. With the opening of the new century he witnessed a reorganization of the Canadian Manufacturers' Association in 1900 which enlarged its membership and established a permanent Tariff Committee in order to be better prepared to deal with the all-important tariff problem from the manufacturer's viewpoint.[2] Shortly afterwards the nationalist elements of Canadian labor established a new, purely Canadian labor organization, the Canadian Federation of Labor, which has practically in all cases supported the Canadian Manufacturers' Association's requests for higher protection.[3]

At the same time, when industry and labor had well-nigh completed their organizational work, and the Canadian Manufacturers' Association was already pressing for a general revision of tariffs, the agrarian class just began setting up its organizations on a regional or provincial level. In 1902 the Dominion Grange revived its activities along with the establishment of the new Farmers' Association of Ontario. In

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2. For a detailed study of C.M.A. see Clark, S.D., The Canadian Manufacturers' Association, Toronto, 1939.

3. The other national labor organization, the Canadian Trades and Labor Congress supported at times the free trade programme. Cf. Logan, H.A., Trade Unions in Canada, Toronto, 1948.

the same year the farmers of the North-West Territories founded their Territorial Grain Growers' Association, which was followed by the Manitoba Grain Growers' Association in the subsequent year. As the settlement of the West progressed, and the rift between farmers and industry deepened, the farmers' organizations were reorganized and consolidated. This organizational process culminated in 1909, with the establishment of an all-Canadian institution, the Canadian Council of Agriculture, which until the middle of the twenties remained the spokesman of the farming interests in Canada.[4]

It is interesting to note that the rise of agriculture as a distinctive Canadian social class during the first decade of this century, aimed at the same problems from the opposite angle, and indeed as the manufacturing group did about thirty years before. From the onset, the farmers' associations followed the traditional Liberal tariff policy and readily supported the party in all federal elections. The controversy which was aroused between the farmers and manufactures during the hearings conducted by Fielding's ministerial commission in 1905-6, was in the main an eastern affair. Both Ontario organizations, the Dominion Grange and the Farmers' Association of Ontario, played a major role in presenting the agrarian view to the commission, while the

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4. Cf. Wood, L.A., A History of Farmers' Movements in Canada, Toronto, 1924.

western groups satisfied themselves more or less with recording their opposition to the high tariff.

Ontario farmers defended the farmers' case so effectively that the government, taken by surprise, was reluctant to follow a straight manufacturers' line. Fielding's tariff reform, introduced towards the end of 1906, although being intended to please both sides, effected the exact opposite, and to a great extent widened further the rift between both groups. The C.M.A.'s officials complained that "the proposed tariff will not encourage either the establishment of new industries or the development of that already established",[5] and made it plain that they intended to press for further changes. The agrarian groups also expressed their disappointment and vigorously attacked the manufacturing industry. The Legislative Committee of the Grange, in its report submitted to the amalgamating convention of both Ontario organizations in September, 1907, voiced a strong resentment against the C.M.A. which, they believed, secured more than the farmers in the tariff reform, and accused it of having broken the truce in the battle for reasonable fiscal legislation. "The pulling infant", the Report said to the convening farmers, "that asked for temporary and moderate protection thirty years ago is now a giant demanding

5. Wood, <u>Op. cit.</u>, p. 251.

that practical prohibition of foreign competition in manufactured goods should be the permanent policy of this country. This demand must be met by the counter demand that the protective principle should be wholly eliminated, and the tariff reduced to a purely revenue basis." The bounty system, reintroduced by the government, was termed as "a gross misappropriation of public funds, and should be unhesitatingly condemned by the farmers of this country on whom the chief burden of the cost will fall".[6]

The improvident utterances made in public by disgruntled business men and the gale of mergers that swept the country during the years 1906-1910[7] were pouring oil into the fire. Farmers, discovering step by step the links between the Ottawa government and manufactures, became painfully aware that their resolutions and petitions were made in vain unless they broke the privileged position of industry protected by the government's fiscal policy based on indirect taxation. The small nation that settled down on the western prairies during the wheat boom, included many British and American immigrants who had brought along with them not only their capital and skill but also their political ideals. Particularly the British could recall the fiscal reforms and the effective

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6. Wood, Op. Cit., p. 252.

7. A good account of mergers which occurred during this period is given in Edward Porritt's The Revolt in Canada, London, 1911, Ch. IV.

working of the income tax in the old country, which suggested a similar solution for their difficulties in Canada. In the federal elections of 1908 the West sent a slate of able men to the House of Commons. Among them was Dr. Michael Clark, elected on the Liberal ticket in the constituency of Red Deer. Dr. Clark was a distinguished English immigrant and he undertook the task of converting Ottawa to direct taxation.

But soon afterwards the agricultural West was also afforded an opportunity to present its grievances and ideas directly to the Prime Minister. In the summer of 1910 Sir Wilfred Laurier suddenly decided to tour the West. The official reason given for this tour was that he wished to get an insight at first hand into the progress and conditions of life in the western part of the country.

Although the trip proved to be a great personal triumph for Laurier, he soon noticed that he had stepped on a hot ground. About five months before, the secretary of the Canadian Manufacturers' Association, G.M. Murray spoke in Winnipeg, and to the astonished western farmers declared that "the reorganized Canadian Manufacturers' Association is like a young giant ignorant of its own power. By the exercise of these powers it could, if it choose, bring several millions of people to the verge of starvation, or paralyse the industry of the whole Dominion"[8]. This thoughtless and astounding boast

8. Porritt, Op. cit., p. 174-175.

evoked such indignation among the western farmers that it spurred their opposition to the utmost. The Grain Growers' Guide aptly remarked:

> "We wish that every one of the 800,000 farmers in Canada could have this statement made by the Secretary of the Manufacturers' Association, to consider. It will be well to have it printed in flaming letters and hung in every farm house in Canada, from the Atlantic to the Pacific. It would be an interesting thing for the farmer and his family to read whenever they purchased a binder or a plough or a carriage or other manufactured articles, the price of which was enhanced by a high tariff. Then the farmer would consider what keeps the tariff up and who benefits by the tariff."9

The tense atmosphere was maintained by the vigorous assailing of the tariff in the farm press that followed this event, and it is rather surprising that the Premier's visit passed without any incidents.

Laurier's tour in the West is a significant point in the history of Canadian fiscal policy. In the cartload of petitions and addresses which Laurier and his suite harvested on the Prairies frequent reference was made to the British fiscal system as a model for modern taxation policy. In Saskatoon, Moose Jaw, Edmonton, Red Deer, to mention some of his stops, the premier and farmers' delegates were touching upon the question of federal direct taxation.

The tenor of the grain growers' case was set out in two

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9. <u>Grain Growers' Guide</u>, Feb. 9, 1910; See also Porritt, <u>Op. cit</u>., p. 175.

memorials prepared for the premier by the Manitoba Grain Growers' Association and presented to him at Brandon by a mass delegation, representing all the local associations in the province. The first memorial notified the Premier that "of the many economic questions which engage the attention of Western farmers none is regarded with so much disapproval as the protective tariff... not because they were unwilling to pay their full share of the cost of government." What they rebel against, the memorial went on, "is the element in the customs tariff which compels them to contribute a large percentage of the products of their labor to the privileged and protected classes ... Nor do they look with favour on any fiscal or preferential tariff that will have the tendency to enhance the cost of living to British artisans and labourers, but rather that every possible facility be given for the free exchange of the food products grown on the prairie farms for the product of Britain's congested factory districts". Then the memorial reminded Laurier of his speech in Winnipeg, delivered in September, 1894, in which he denounced the policy of protection as bondage and slavery, and particularized the burden the tariff imposed on the farmer. The second memorial stated that "whereas the prices for farm products are fixed on the world markets by supply and demand and free competition, the supplies for farms are purchased in a restricted market where the prices are fixed by

combinations of manufacturers and other business interests operating under the shelter of a protective tariff." Owing to those conditions, the document went on, "the farmers strongly urge that such a change be made in our fiscal policy as will give them a square deal". Then the memorial recorded the western support for the reciprocity with the United States.[10]

Similar demands for a new commercial and fiscal policy were reiterated by all farmers' delegations of the three prairie provinces which met the Premier. In his replies to the farmers Laurier endeavored to pour oil on troubled waters. The audience in Saskatoon was told that "to abolish the tariff at one stroke would create a financial crisis. It is impossible for us now to raise revenue as in England."[11] In Regina he warned in his reply: "Changes must be gradual. It would not be possible for us to raise our revenue by direct taxation. If we did, the first party to suffer would be the settlers, and the first goal to be set before us is the settlement of those enormous prairies".[12] The solid and unified stand of the West was impressing Laurier. To the Liberal Association at Moose Jaw he stated that Bright and Cobden were

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10. The Grain Growers' Guide, July 27, 1910.

11. The Globe, Toronto, July 30, 1910.

12. Weekly Phoenix, Saskatoon, August 3, 1910. Quoted by Porritt, Op.cit., p.200.

his models as to the fiscal system. "But we cannot today", he emphasized, "give you the full policy of Britain. The Motherland is a nation made. Canada is a nation in making. But we can give you trade. We have given you free trade, and mean to give you free trade, and I don't think it is going too far to say that the Government will give you still freer trade."[13]

An unexpected endorsation for the grain growers' movement was given at Moose Jaw by the Associated Boards of Trade of the West. President Saunders, manager of the Bank of Commerce who led the deputation consisting of bankers, businessmen and manufacturers urging government assistance to the Canadian Exhibition in the West, was interviewed by a member of Laurier's suite as to the feelings of the Association and its members in regard to the farmers' free trade propaganda. His answer was:

> "We absolutely exclude party politics from our organization, but there is a general and strong sentiment in favour of a material reduction in the tariff. While we are leaving the grain growers to present their own case, the sympathy of the Boards of Trade, the business men, and even the manufacturers, is unquestionably with them. As a matter of fact, there are no party politics in the West, as we know them in the East, no hidebound allegiance to political names. The West is more concerned over policy than party, and the dominant policy at the present time is tariff reduction."

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13. The Globe, Toronto, August 6, 1910.

As the correspondent of the Globe added to his dispatch, 'unquestionably the Premier struck a responsive note in his reference to the British free trade policy'.[14]

The denunciation of the protective tariff, manufacturers, and monopolies, and the critique of Liberal fiscal policy was continued with no less vigour also in Alberta. At the Red Deer meeting, J. Speakman, a director of the United Farmers of Alberta delivered a very effective and well-documented address on the regressivity of tariff taxation. He estimated that for every dollar of duty going into the revenue, about three dollars were taken out of the pocket of the people, due to the cumulative effect of the tariff, which imposed an extra burden per capita of $20, or per family of $100. On his homebound trip Laurier made a last stop at Lethbridge where a deputation of the southern associations awaited him and reiterated the farmers' views for the purpose of showing the Premier that the farmers of the north and south were united in their demands. In his reply to the address Laurier again touched upon direct taxation. "Personally," said the Premier, "he was a free trader, and wished they could have a free trade as they had in England. But that was impossible. In England, where there were large estates, incomes

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14. Ibidem. A good description of Laurier's western tour may be found in Porritt, Op. Cit., pp. 184-221

and land monopoly, they were able to raise their revenue by direct taxation. In Canada they had few millionaries, and, thanks to God, no land monopoly, so were compelled to raise revenue by means of customs duties."[15]

Laurier's comment on his trip[16] may be well applied to farmers of the Prairies as well. They learned from the best authority of the difficulties the Government had to face and struggle through when framing its budget policy. The other side of protection was the question of a sufficient revenue base warranting the huge developmental programme of the government carried on, chiefly in the West. It had become clear to them that their arguments for lower tariffs were archaic in view of heavy govermental expenditures. To make their demands acceptable to the government they had to to suggest an alternative source of revenue which would provide for the loss incurred by a substantial tariff revision. In December of the same year, direct taxation was proposed to the federal government as a solution by farmers' representatives from all provinces, and since then it became a lively political issue.

The "Siege" of Ottawa.

The wide publicity afforded the Premier's tour of the

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15. Daily Herald, Lethbridge, Sept. 1, 1910. Quoted by Porritt, op.cit., p.223.

16. "I do not know that I ever enjoyed a trip more. It has been like a revelation and an education". Laurier at Golden, B.C., Aug.15, 1910. Quoted by Porritt, op. cit., p.176.

West by the Canadian press could not escape the attention of the protectionist interest. The annual convention of the C. M. A., held in Vancouver, B.C., three weeks after Laurier's trip ended, was seized upon by manufacturers to defend their case. The temper of manufacturers was up, and many of them availed themselves of freedom of speech. The most fiery criticism of farmers' demands came from that influential Toronto group which, ten years afterward, Col. J.B. MacLean of The Financial Post described as "a clique of third and fourth rate men, several of whom were failures in their undertakings".[17] The convention went on record for all-out support of protection and voted the establishment of the Tariff Education Fund to polarize the propaganda for free trade and reciprocity.

The reaction of farmers was immediate and inciting. The Grain Growers' Guide ran an editorial, "Manufacturers Throw Down Gauntlet", in which the C.M.A.'s resolutions were called a contempt for the will of the people and added: "The Vancouver convention of the manufacturers should prove to be the greatest blessing to the farmers of Canada that has fallen upon them. The farmers will not sit under the system of the legalized robbery and allow manufacturers to hurl such a challenge into their teeth. The farmers are aroused, they now see the danger face to face."[18] The Weekly Sun, the Ontario

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17. The Financial Post, May 29th, 1920.

1 8. Grain Growers' Guide, Sept. 28th, 1910.

farm paper, suggested a mass delegation of farmers from all parts of Canada to go to Ottawa which were to prove to the Government that the Western farmers did not stand alone.[19] The Canadian Council of Agriculture seized upon the suggestion, and assumed the responsibility for carrying out the plan. On December 16, a mass delegation (over eight hundred members) presented a list of resolutions to Parliament.

The Farmers' Platform, as the brief was henceforth called, referred for the first time to direct taxation. The fifth point of the platform stated that "the farmers of this country are willing to face direct taxation in such a form as it may be advisable to make up the revenue".[20] Albeit the point or the address did not specify the form of direct taxation, it fulfilled one of its purposes: the ice of Eastern opposition to direct taxation had been definitely broken.

The farmers' "siege" of Ottawa started one of the most turbulent political fights in Canadian history. The controversy over the tariff flared up in the House of Commons and was carried to the electorate in the fall elections of 1911, which ended with a disastrous defeat of the government. Even the farmers' forces in the West did not stick to their demands. The Province of Manitoba went Conservative with a majority of

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19. At this time the negotiations on reciprocity between Ottawa and Washington were satisfactorily proceeding.

20. Siege of Ottawa, Pamphlet published by Canadian Council of Agriculture, Winnipeg, 1910.

nearly 6,000 votes.[21]

Were the Farmers' Demands Justified?

Although it is not our intention to evaluate the events and issues which brought about the fall of Laurier's Ministry, one question presses for an answer: Was Canada economically mature at that time for a federal direct tax?[22] The answer is, by all means, in the affirmative. The spectacular growth of agriculture during the wheat boom was well matched by the industrial expansion concentrated in the Provinces of Ontario and Quebec. Whereas the total capital invested in agriculture rose from $780 millions in 1896 to $1,705 millions in 1913, the total capital employed in manufacturing jumped from $447 millions to $1,248 millions, and the net value of products of manufacturing industries rose from about $215 million to $564 million.[23] The merger fever between 1904-11 led to the establishment of some forty-one industrial corporations that absorbed 196 separate smaller companies, and boosted their capitalization from $125 million to $355 million.[24]

Under the fiscal system based on indirect taxation the profits

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21. Cf. Wood, op. cit., p. 270.

22. Here we mean exclusively the personal and corporate income tax.

23. Royal Commission on Dominion-Provincial Relations, Report, Book I, pp. 73-76.

24. Monetary Times, Toronto, January 6, 1912. Also MacDiarmid, op. cit., p. 244.

from such a huge industrial investment practically escaped taxation, which, in turn, created a serious disparity as to the impact of the average burden of taxation on various occupational groups. The complaints of the farmer of being over-taxed on account of industry were wholly justified, and the situation could have been remedied only by introducing an income tax. But the cry of the farmer, even carried by himself to the Parliament, was misunderstood by the government as well as by the opposition, which in addition did not hesitate to hold the side of vested interests not only during the election campaign, but also afterwards.

Direct Tax Movement at a Low Ebb

The new Conservative Ministry led by Sir Robert L. Borden buried all hopes for a radical remodeling of the Dominion fiscal system. The new Minister of Finance, Mr. T. White was trapped between the Scylla of public opinion and the Charybdis of his conservative friends, and provided but a weathercock-like leadership in fiscal policy.

The income tax movement, after the unsuccessful bid for power in 1911, marked a low ebb in the years immediately preceding the outbreak of war. The Grain Growers' Guide kept the flame alive commenting on the American moves for a federal income tax, and the Gladstonian Liberal, Dr. Michael Clark, ploughed his lonely furrow, to use A. Meighen's allegory, in the House of Commons. A creeping depression and worsening

international situation overshadowed the tariff issue.

The adoption of income tax in United States together with an insistent pressure of military men for increased defence spending gave new momentum to the movement. In June, 1914, the Grain Growers Guide came out with an open demand for an income tax in Canada. In an editorial, "Income Tax", the editor wrote:

> "The advocacy of a Free Trade is never complete and convincing unless it is supplemented by a sound and practical plan for the raising of revenue which would be lost by the abolition of tariff taxes. Among the alternatives perhaps which appeals strongly to the majority of the people is the income tax, which in the main source of revenue in Great Britain..."

After a good account of the British income tax history and American legislation, the editor asked:

> "Now, is there any reason under high heaven why an income tax should not be introduced in Canada? We have never heard it mentioned except in whispers at Ottawa, but if the progressive elements of the Dominion are wise they will advocate it with stern persistency from this time forward.... the sooner the leaders of progress begin to advocate its institution the better for their hope of eventual political success. They might actually be surprised to find how popular it was with the mass of the electorate."

The editor also called for compelling "the class of rich shareholders to take up their proper share of the national burden" and for imposing a heavy super-tax upon "our plutocracy".[25] It would be of much interest to follow the path of a fight for an income tax in Canada, which would undoubtedly evolve from

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25. Grain Growers' Guide, June 24, 1914, p. 769.

this battle cry. However, the war events intervened and gave an entirely different course to the movement, effacing considerably its class character.

Fiscal Controversy During the War.

When the war broke out, the immediate problems and difficulties were more of monetary than of fiscal character. The financial panic which seized, first Toronto and then Montreal, and threatened to deplete the gold reserves of banks, necessitated the suspension of gold payments. The banks were authorized to pay off their liabilities in their own notes and the public was informed that the government was prepared to use all existing powers to prevent any interruption of business conditions.[26] Parliament was summoned to a special session in the second half of the month of August to deal with the whole situation.

Since the British government was willing to provide the necessary funds through the Bank of England for financing the Canadian war expenditures at the early stage of war, the Minister of Finance was not compelled to introduce any major fiscal measures to the sitting House of Commons, and he satisfied himself with an increase of tariff rates on such reliable revenue producers as tea, cocoa, coffee, sugar and tobacco.[27] There were

25. Grain Growers' Guide, June 24, 1914, p. 769.

26. A moratorium was considered, but later on found unnecessary.

27. Statutes of Canada, 5 Geo. V., c. 5.

hardly any critics of the bill except Mr. Clark. Albeit pledging his support to the bill he disliked the idea of beginning to impose the war burden from the bottom. In the course of his speech he pointed out:

> "... that it would have been a most fortunate moment for the government to have tried a little incursion into the realm of direct taxation. That should have been a triumph of the abnormal in Canada. Instead of increasing the duties which bear upon the poor, they could have had the great mass of the people of this country behind them if they had put a good fat tax upon all incomes above $1,500a year. I offer that suggestion to him (the Minister of Finance) and to the Government as one well worthy of their consideration." 28

Clark's proposal of an income tax got but scanty attention from the press. Both Liberal and Conservative newspapers commended the measures introduced by Sir T. White, and expressed the opinion that the time was inappropriate for any innovations.[29] Perhaps at this particular point it would have been difficult to follow Mr. Clark's advice, for nobody could foresee what part Canada was to play in the conflict, and, as a consequence, what sacrifices she would have to make. The general attitude was antimilitaristic across the country, and in the absence of any signficant military force Canada's role seemed to be limited to some kind of economic support of the Mother Country. It was therefore wise to avoid anything that could shake an economic system still tormented with a depression.

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28. Debates, 1914, Special Session, p. 41.

29. Cf. The Financial Post, August 22, 1914; The Globe, Toronto, August 21, 1914; The Gazette, Montreal, August 21, 1914.

However, as the war progressed, the problems of war finance became more acute and more discussed. The income tax put forward by Mr. Clark to the Government and to the public started to get attention. As may have been expected, the West was in the van of the drive. The conventions of the provincial farmers' bodies adopted resolutions in favor of a graduated income tax, during the early months of 1915. At the annual convention of the Manitoba Grain Growers' Association held in January, 1915, an address was delivered by A.B. Clark, Professor of Political Economy at the University of Manitoba, on "Canadian Fiscal Policy". Professor Clark bitterly attacked the government and said that "under the shelter of the high ideals of National Strength we have, in fact, revived on behalf of the combines the old right enjoyed by the feudal barons of the Middle Ages - the right of private taxation." He remarked:

> "I have been told that the idea of an income tax is not popular in Canada. None of us keenly desires to have our incomes taxed. But if we look below the surface we see at once that, by means of high prices of necessaries such as clothing and the instruments of production, the present system levies really an exorbitant tax, and an unequal tax on incomes, and more expecially on the income of the farmer.... The institution of the income tax would mean the speedy end of a system under which fiscal legislation is manipulated in the interest of special classes, and the substitution of legislation in the interest of the nation as a whole." 30

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30. Manitoba Grain Growers' Association, 12th Annual Conference held at Brandon, Jan. 13-15, 1915, <u>Minutes of Proceedings</u>, p. 26 ff.

Similar demands and suggestions as to what taxes he should introduce to meet the additional expenditures were forwarded to the Minister of Finance but most of them were amateurish advice lacking wholly in adequacy to meet the situation.

The country awaited the war budget with much attention. It was the first time in the history of the Dominion that the Minister of Finance was called upon to mobilize the nation's economy for war purposes, and the general feeling prevailed that the budget would introduce sweeping changes in the government's fiscal policy. However, the budget speech as delivered on February 11, 1915, exposed helplessness, instead of leadership, and hardly pleased anybody but big business. To finance the war the government decided to adhere to the principles of National Policy reinstated a year ago, viz., higher tariff rates and larger borrowing, supplemented with some ancillary direct taxes limited in yield and duration. The great engine of war finance, the income tax, was left out as an insufficient instrument. Accordingly, the Budget introduced an over-all increase of tariff rates, 5 per cent under the British Preference, 7 1/2 per cent under the intermediate and general schedule, plus a host of direct taxes on consumption and financial companies.

The Minister of Finance, speaking for the proposed measures, reminded the House that the tariff was the mainstay of the Dominion revenue system, and the government had to look to this

instrument for relief of fiscal conditions. He believed that the increased customs duties would bear upon all classes of the community making every member feel that he was to that extent contributing to the defence of the country. The proposed new direct taxes were designed to levy an additional burden upon those taxpayers who were best able to sustain it. Expecting criticism from income tax supporters, he felt it necessary to make clear the position of the government on the matter.[31] He listed three main reasons against the income tax: (1) the administrative difficulties, including evasion; (2) its small fiscal yield; and (3) the impact of a federal income

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31. "It will be observed that I have omitted income tax upon individuals, about which there has been some discussion since the outbreak of the war. The matter has had the consideration of the government and it appears clear to us that such a tax is not expedient, at all events, for the present.... In order to bring into force an income tax the government would be obliged to create machinery for assessment, revision and collection. This would involve a heavy expenditure as compared with the amount which would be realized. Taking the income tax of the United States as a basis it would appear that it could hardly expect to derive from a similar tax a sum in excess of two million dollars, from which would have to be deducted the heavy expense connected with its administration. My chief objection, however, to an income tax is the fact that several provinces are also likely to be obliged to resort to measures for raising additional revenue, and I am of the view that the Dominion should not enter upon the domain to which they are confined to a greater degree than is necessary in the national interest. There is another feature of income tax which makes it unsatisfactory for the purpose of the Dominion finance. I refer to the length of period which must elapse before it becomes productive. In Britain, where the tax is the chief source of revenue to the Imperial Government there is no municipal taxation upon incomes. There is also the important difference that in Britain taxable incomes are derived largely from investments. They have therefore a settled character, are ascertainable with fair accuracy and are capable of being levied upon at their source. With us this is not the case." (Sir T. White, Budget Speech, Feb. 11, 1915, p. 86)

tax upon the provincial revenues. By all means the last point was the strongest one. The Minister had accurately foreseen the difficulties which arose ten years later and prevented the Dominion from employing the tax to the fullest extent until the World War II.

The most alarming feature of White's budget was an implicit admission of the government that it was not able to frame a positive fiscal policy needed for the prosecution of the war. The Minister of Finance, by ruling out the income tax from federal fiscal instruments, stultified his whole fiscal policy. The restricted scope of taxation could by no means guarantee the revenue needed to meet the mounting war expenditures plus the capital investment which the government intended to carry on. Evidently, it counted heavily upon extensive borrowing. But the only Canadian source of loaned funds, the British market, was also under a heavy strain, and the government itself was impairing this source further by imposing prohibitive tariff rates on British goods, thus defeating its own plan. Hitherto, Canadian securities were practically unknown to the American investor, and the domestic market was an unexplored frontier, so that the government could rely upon those sources at that stage only to a very limited degree. The choice between an income tax and inflation, as it stood implicitly before the government, was decided in favor of inflation, and the Minister deliberately enhanced it to a considerable degree.

The opposition showed no less confusion than the government during the budget debate. Indeed, they had broken the party truce and seriously criticized the budget. The debate was conducted along the standard lines of government waste and high tariff policy, and the official spokesman of the opposition, Mr. A.K. MacLean refrained from taking up the issue of the income tax with the Minister of Finance. The champion of income taxation in the House of Commons, Dr. Clark spoke in eloquent terms on the matter, yet he was not equipped to refute the specific objections against the tax made by the Minister. What he and the country needed was an expert and unbiased view on Canadian fiscal policy void of political, regional, or class flavour.

It is quite dubious what turn Canadian public finance would have taken during the subsequent war years, had Dr. Skelton of Queen's University not intervened with his small but classic study on federal fiscal policy,[32] in which he exposed the defects of the whole Canadian fiscal structure, and stated in a very forceful manner the case for the introduction of an income tax into the federal revenue system. After the Keynesian-like outline of the functions of public finance in the nation's economy he surveyed all the possible fields of taxation listing their pros and cons, and arrived to a conclusion that from all the medley of taxes the income tax and

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32. Skelton, O.D., Federal Finance, I, Bulletin of the Department of History and Political and Economic Science in Queen's University, No. 16, Kingston, Ontario, 1915.

succession duties represented the best form of taxation. Their adoption into the federal system he deemed too obvious to be discussed under the existing war conditions. He entirely disagreed with Mr. White that the objections raised by him in the budget speech were so serious as to make the tax unacceptable to the Dominion government.

Skelton estimated in his study, that an eventual yield of a federal income tax would amount to about $37 million as against Mr. White's estimate of two million dollars, basing his calculations on more exact figures of British income tax and Wisconsin tax yields. As to the impact of a federal income tax upon provincial finances he saw a clear advantage in such a tax which could serve as a uniform measure for both the Dominion and the provinces in levying a tax upon incomes. He did not deny the serious administrative problems in Canada, but they were common in each state and everywhere they have been successfully overcome. And referring to the objection raised by the editor of _The Gazette_[33] he indignantly wrote that "anyone who fears to adopt an income tax solely because of the risk of evasion must believe either that Canadian citizens are liars beyond all other men or that Canadian statesmen and officials are incompetent beyond all others.[34]

33. "Mr. White acted wisely in not resorting to an income tax, though he will be blamed by those who regard it as the best and surest way of making the rich pay their share of the national burden, especially if it is a graduated or progressive one... Of the whole category of imposts none is more easily evaded." _The Gazette_, Feb. 12, 1915.

34. Skelton, _Op. cit._, p. 34.

Skelton's concise study exercised a distinctive influence upon the future course of federal finance. He armed the supporters with an authoritative documented paper, and also converted many broad-minded men to a fiscal reform. When subsequent events , particularly the closing of the British money market endangered the position of the treasury, even Mr. White had two measures drafted, one imposing a tax upon excess profits and the second, an income tax bill. But sticking to big business gospel that the income tax was not suitable for financing the war, Mr. White declined to introduce the income tax bill, and put through only the Excess Profits Tax Act.[35]

In his budget brought down early in February, 1916, The minister avoided discussion of the income tax, stating that his views had not been changed. However, the Liberal Opposition went all-out for support of its introduction. Mr. McLean, the official spokesman of the opposition, incorporated Skelton's arguments into his speech and addressing the House on the budget proposals, he said :

> "In view of the fact that hereafter in this country we shall for many years require more revenue than we can possibly secure from customs and excises, we might as well begin now and adopt a broad system of taxation based upon incomes, which would reach all persons in equitable proportions and without any discrimination. By such a method we should reach every business concern which the minister is attempting to reach by his proposals but in a much better and more just manner. The minister will probably find that next he will have to invoke some system of direct taxation." [36]

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35. The Act taxed profits in excess of 7% of the paid-up capital at the rate of 10% and 25% in the case of an unincorporated and incorporated business respectively.Enterprises with the paid-up capitall less than $50,000 were exempt save those manufacturing war supplies and ammunitions.

36. Debates, 1916, p. 902.

Mr. MacLean did not share the view of the Minister of Finance, that the provincial income taxes posed any serious obstacles to a federal tax for, in his opinion, the income tax was in operation in some of the provinces. It was only levied in theory; generally speaking, there was no income taxation.[37] It is also worthwhile to note that the only Labor member of the House, Alfonse Verville, followed the Liberal line urging direct taxation beginning with parliamentarians' salaries and indemnities.

Toward the end of 1916 the country was practically converted to income taxation except for a small group of well-to-do people who feared that the tax would take too much from their incomes. It was therefore rather surprising that the federal government hesitated to impose heavier taxes albeit the fact that two subsequent domestic loans and other events[38] were indicating that the nation reacted more than favorably to any appeal for funds, and that the financial position of the country was generally underestimated. While the public, instead of complaining of being overtaxed, demanded more taxation, the government was borrowing at home and abroad. The farmers' organizations, which were answering every call for support and sacrifice from a government, they disliked as much as the tariff, grew dissatisfied with the government's protection of the group

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37. Ibidem.

38. The farmers' locals in the West pledged their members to support the Imperial cause by free contributions of wheat and other agricultural products.

they called profiteers and speculators.

There were again signs of political activity among farmers around this time. The Canadian Council of Agriculture promulgated a revised Farmers' Platform which embodied the former demands of the agrarian class in a more specific form. The Platform called for a direct tax on improved land values, including all natural resources, a sharply graduated tax upon all incomes over $4,000 a year, a heavy graduated inheritance tax on large estates, and a graduated income tax on profits of corporations over ten per cent.

The borrowing policy inaugurated by the government during 1916, viz., issuance of tax exempt bonds, signalized the income tax for 1917. The bill had been drafted with the Excess Profits Tax Act, and even the backers of the Finance Minister were expecting it. However, the mysterious Mr. White of whom later Dr. M. Clark remarked that "no reed which ever shook its slender tip in a summer wind could compare with the Ex-Minister as an emblem of instability", had another surprise in store for forecasters. In his third war budget speech of April 24, 1917, the Minister told the House that the income tax was not well suited for financing the war as far as Canada is concerned. To a certain degree he took issue with Dr. Skelton's arguments in favor of a tax upon incomes as put forward in the paper mentioned. Passing on the proposition that Canada should follow Great Britain and the United States by imposing a tax upon incomes beyond $1,000 or $2000, Mr. White stated that a comparison

of Canada with either of those countries was fallacious. He listed the following reasons to support his stand: (1) that Canada was not a country of large accumulated wealth and incomes derived from investments; (2) that the maximum amount which could be obtained from such a tax in Canada would, in terms of Dominion finance, be comparatively small, and its administration would require almost a second civil service sufficient in number to cover every municipality, rural and urban, throughout the Dominion; (3) that the costs of the levy would be proportionately heavier than in England or in the United States; (4) that some of the provincial and municipal governments were already taxing incomes; (5) that the larger incomes derived from holdings in joint stock companies were meanwhile subject to the Business Profits War Tax Act; and (6) that the Canadian public voluntarily was supporting the Canadian Patriotic Fund, Red Cross and other funds, and the amount contributed annually to these funds was much in excess of the amount likely to be realized from any income tax. But above these reasons he added that "if such a tax is to be imposed, it seems to me that so far as the great majority of Canadians are concerned, it might be better to be levied in time of peace".[39] At the same time he proposed substantial increases in the rates of the Excess Profits War Tax Act.

It would hardly be of much avail to discuss anew the Minister's objections to an income tax. There is ample evidence

39. Budget Speech, 1917, p. 719 ff.

that he did not believe in them,[40] the more so that three months later he introduced the tax despite the strong objections he had heaped up during the previous two years.

The budget elicited a wave of criticism from all corners of the country. The attacks from income tax supporters were to be expected. But to his surprise his own political backers rebelled against the heavy and discriminatory taxation of selected profits of business enterprises. About three weeks following the budget speech The Financial Post, which was defending Mr. White's policies during the war and before, stated editorially:

> "In his tax on profits the Minister has gone too far in one direction. He must modify it before it is too late, and if he finds it necessary to replace some revenue which he thinks is going to be lost thereby, then put some tax upon those articles, the consumption of which should be restricted in Canada today. Put some tax on great incomes -- ranging from $100,000 to $1,000,000 a year -- which are drawn by people who have their investment in bonds and mortgages -- much of whose money was made in real estate and other speculation -- and who are themselves taking no risk and contributing nothing by their enterprises or ability to the production in the country."[41]

The year of 1917 was, perhaps, the most critical period of the war. The nation felt the full impact of the war burden and the government was clearly failing to give a leadership the country needed in such a trying hour. The Prime Minister faced

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40. In the realm of finance, the sentiment of the public was reflected in a desire for heavier taxation. This was partly caused by the failure of some well-to-do people to contribute as generously as they should have to the patriotic and other war funds. Sir Thomas White, The Story of War Finance, p.53.

41. The Financial Post, Editorial, May 19, 1917.

the nation with the necessity of further sacrifices in man-power and wealth but he did not unfold a program for meeting the situation. He let the issue of conscription get out of the hands of the government which, thrown into the political arena, could cause only serious damage and weaken the country.

When the budget speech exposed the helplessness of the government, public opinion was turned not only against the government but also against the whole parliament. The demands for removal of some cabinet members and even calls for a new leadership were appearing in the press.

The conscription issue elicited an agitation for "conscription of wealth" in the West and in Ontario. It was in the farming communities that the catch-phrase attracted most attention. They conditioned their consent to the conscription of men with a conscription of wealth, which in essence meant adopting a good stiff income tax. The Canadian Council of Agriculture at its meeting held in June manifested agrarian feelings by dropping from its platform the minimum exemption of $4,000, thus indicating that the farmers were willing to do their share and support the Imperial case. The Guide in its editorial advised the government that it "will find that a great deal of the opposition to conscription of men will disappear if a heavily graduated income tax is adopted and more of that opposition will disappear if further taxes are imposed so that every man who is not fighting will be forced to do some paying".[42]

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42. The Guide, June 20, 1917, editorial.

Indeed, similar demands for a fair distribution of the war burden were voiced by other members of the community as well. It is worthwhile to record that the Montreal Board of Trade some days before the Income Tax Bill was introduced in the House had sent a deputation to Ottawa to request the government to do something whereby every citizen would, proportionately to his means, share the nation's burden. When asked what they would suggest, they pointed to the income tax.[43]

Sir Robert Borden and his party, assessing public opinion in view of unavoidable federal elections, which seemed to signalize defeat, decided to woo the farmers and compelled Sir Thomas White to denounce his fiscal heresy. When he rose in the House of Commons on July 25, 1917, to lay before the House the Income Tax Bill, repudiated three months before, he was definitely a beaten man on the issue. Instead of being a master of events he had become an instrument of the irony of fate which not for the first time played its Delphic game with politicians.

At this point, a historian of the Canadian income tax, eager to parallel the eloquence of Pitt, Peel, Gladstone or

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43. "I was the spokesman of the deputation, and when Sir Thomas White asked me what we would suggest I said we were not there to suggest, but to lay the facts before him and leave it up to him. So he insisted so much upon me saying something that I said: 'Well, there is the income tax, you know, and you might possibly use it! He said: 'That goes to the privilege of rights'. I said: 'Maybe so, but then find a new law by which every man will come in and do his share according to his revenue'." (Mr. Zeph. Herbert, Citizens' Research Institute of Canada, Convention Proceedings, Canadian Tax Conference, Montreal, Oct. 17-18, 1929, p. 45.)

other great finance ministers with the rhetoric of Sir T. White must save space. His speech for the bill was cool and indifferent. He substantiated the introduction of the bill by the expected increase of military expenditures connected with universal military service and maintaining the credit of the Dominion. He added:

> "Apart from this necessity from a financial standpoint there has arisen, in connection with the Military Service Bill, both in this House and in the country a very natural and, in my view a very just, sentiment that who are in the enjoyment of substantial incomes should substantially and directly contribute to the growing war expenditures of the Dominion. In view of this consideration I desire today to lay before this Committee proposals for a national measure of income taxation. I may say that the adoption of such a measure is a distinct innovation in federal fiscal legislation.... As I have stated, the provinces and the municipalities are confined to direct taxation, and I have not regarded it expedient, except in case of manifest public necessity, such as I believe exists at the present time, that the Dominion should invade the field to which the provinces are solely confined for the raising of their revenue." 44

As we have pointed out above, the objection of aggravating Dominion-provincial fiscal relations was a weighty one.

Despite its very mild form, the income tax was accepted by the opposition and the country with much relief. In fact, it was a victory of the joint progressive forces of the country, but particularly of the West. And if there is only a bit of truth in the eulogy of Gladstone on the income tax, then the West deserves the credit for its introduction into the federal

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44. Debates, 1917, p. 3760.

fiscal system and the "red" Michael Clark, the Gladstonian Liberal the honours.

Influence of War.

Hitherto we have followed the broad social currents which were instrumental in persuading the Minister of Finance to usher into the federal fiscal system the income tax. It has, however, been pointed out that the exigencies of war speeded up the fiscal metamorphosis, and therefore a short account of Canadian war finance is in place.

The outbreak of hostilities had caught the country entirely unprepared and in the midst of an economic slump. The obsolete fiscal system, fostered by the party in power, the lack of any comprehensive plan, and last but not least, insufficient economic data, prevented the government from employing the latent powers of the country in full within a short time. It was bound to improvise at the outbreak of war, and the first measures adopted in the summer of 1914 were unavoidable.

Due to the arrangements with the Imperial government, which assumed responsibility for the maintenance of Canadian forces on the front, the Dominion government was in a comparatively comfortable position since the whole problem of war financing depended upon its ability to secure the necessary funds in Great Britain which was readily arranged with the Bank of England. From this source were met practically all expenditures for that purpose amounting to $ 60 million. The problem of financing the capital outlays and the deficit on current account was solved

by an additional loan in Great Britain, $40 million in total, and by a fiduciary issue of Dominion notes in an amount of $39 million and a small short term loan from the Bank of Montreal.

The budget message of 1915 was prepared under the optimistic impression that the existing arrangements would continue, The Minister of Finance argued quite carefully that the Canadian economy was not sufficiently developed to bear the burden of war costs, and that therefore they had to be shifted to future generations which would be in a better position to sustain the load. He satisfied himself with minor taxes and an over-all increase of customs duties which were to cover the expenditures on current and capital account.

When pressing war conditions compelled the Imperial Government to terminate any foreign borrowing, the Dominion government was thrown upon its own resources, and the Minister of Finance was faced with the task of securing $160 million for the direct war costs of the Dominion plus additional funds to finance British purchases in Canada were they not to be seriously curtailed. In August he successfully arranged a short term loan from a New York investment house, and in November the first domestic loan was floated. The tremendous success of this loan surprised many, but mainly the Minister, who felt greatly relieved. The loan called for $50 million and twice as much was offered within a few days. The loan by itself proved that Canada's economic potential was greatly underesti-

mated, and that she was able to carry her load alone. Canadians were willing not only to support their government but also subscribed to the British-French loan and the Russian loan selling in New York which made the Minister of Finance issue an appeal asking the Canadian public to preserve the funds for the needs of the country.

Although the marked success of the first loan furnished clear evidence of favorable conditions for heavier taxation, Sir Thomas White anew refused recourse to income taxation and pursued a vigorous borrowing policy to meet mounting war costs. After negotiating a loan of $75 millions on the New York market, which was more or less a refunding operation, he decided to tap domestic sources. In September, 1916, the second domestic war loan was floated and then in March, 1917, the third war loan was offered. Both loans were enthusiastically accepted by the public and heavily over-subscribed, although the government was asking for $250 millions in total. To be sure, the terms of securities offered were more than favorable[45] as to make the investment attractive. As Skelton pointed out, later, it did not require a miraculous amount of patriotism to accept 5 1/2 per cent interest for one's money on an absolutely safe security, when at the same time U.S. securities were offering but 4 1/2 per cent interest.[46]

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45. See Table I.

46. Skelton, D.O., Federal Finance II, Bulletin of the Departments of History and Economic Science, Queen's University, No. 29, Kingston, 1918.

TABLE I.

A SUMMARY OF LONG-TERM BORROWING OF THE FEDERAL GOVERNMENT DURING THE YEARS 1915-20

1. Loans floated in the United Kingdom:	
March, 1915, 4 1/2%, at 99 1/2, maturity 5-10 years	$23,332,500.
2. Loans floated in the United States:	
August, 1915, 5%, one year notes at 100, two year notes at 99 1/2, less commission	45,000,000.
March, 1916, 5%, 5-10-15 years at 99.56, 99.12 and 94.94	75,000,000.
August, 1917, 5%, two year notes at 98	100,000,000.
3. Loans floated in Canada:	
November, 1915, 5%, 10 years at 97 1/2 (24,862 subscribers)	$100,000,000.
September, 1916, 5%, 15 years, at 97 1/2 (34,526 subscribers)	100,000,000.
March, 1917, 5%, 20 years, at 96 (41,263 subscribers)	150,000,000.
November, 1917, 5 1/2%, 5-10-20 years, at 100 (602,000 subscribers)	400,000,000.
November, 1918, 5 1/2%, 5-15 years (1,064,497 subscribers)	600,000,000.
November, 1919, 5 1/2%, 5-15 years (830,602 subscribers)	600,000,000.

Sources: *Budget Speeches*, *Canada Yearbook*, and *The Canadian Annual Review, 1915-1920*.

While the borrowed money was pouring into the treasury, the tax revenue moved but slowly upward. The special war taxes yielded a negligible amount prior to the introduction of the business profits tax, which yielded $16 millions in 1917, a very modest amount indeed. But the total receipts in current account, which passed the $200 million mark during the fiscal year 1916-17, were used up by requirements on the current and capital account.[47] Although in 1917 the government was able for the first time to transfer the amount of $41 millions to its war account, it could not affect materially the over-all financing. The apprehensiveness of the Minister of Finance in his tax policy may be aptly illustrated by paralleling his borrowing and taxation legislation. The first domestic loan, subscribed by big business enterprises induced the business profits tax. Then the second loan, doubled in amount, was followed by a substantial increase in rates of the same tax. Finally, the third loan, which due to its larger number of subscribers, might be termed a "popular" loan, led to the income tax, equally a "popular" tax. Hence, the fiscal policy of the government ensued from its borrowing policy, even though in a much milder form.

The effects of the unbalanced fiscal policy began showing up in the second half of 1916. Banks, being freed from any checks on their credit policy by the Finance Act of 1914,

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47. See Table II.

TABLE II. A SUMMARY OF REVENUES, DEBT, AND EXPENDITURES,[1]

DOMINION OF CANADA, 1914 - 1920.

($000)

	1913-14	1914-15	1915-16	1916-17	1917-18	1918-19	1919-20
REVENUE:							
Customs Duties	104,691	75,941	98,649	134,044	144,173	147,169	168,797
Excise Duties	21,452	21,479	22,428	24,412	27,168	30,342	42,698
War Taxes	-	98	3,621	16,302	25,379	56,177	82,080
Total Tax Revenue	126,143	97,519	124,667	174,758	196,721	233,689	293,575
Consol. Fund Revenue [2]	163,174	133,073	172,148	232,701	260,779	312,947	349,746
Net Addition to Debt	21,695	113,379	165,780	264,030	312,697	382,646	674,337
TOTAL REVENUE [3]	186,241	248,098	339,702	498,203	576,660	697,042	786,031
DEBT:							
Gross Debt	544,391	700,473	936,987	1,382,003	1,863,335	2,676,635	3,041,530
Net Debt	335,997	449,376	615,156	879,186	1,191,884	1,574,531	2,248,869
EXPENDITURES:							
Cons. Account Exp.	127,384	135,523	130,351	148,559	178,284	232,731	303,843
Capital Exp. [3]	37,180	41,447	38,566	26,880	43,111	25,031	69,301
War Expend.	-	60,750	166,197	306,488	343,836	446,519	346,612
TOTAL EXPEND. [4]	186,241	248,098	339,702	498,203	576,660	697,042	786,031

1. The Canada Year Book, 1940.
2. Non-Tax Revenue Inclusive.
3. Includes Sinking Fund.
4. Includes Other Charges.

expanded the money supply by well-nigh $300 millions within about six months' time.[48] As Chart 1 shows, the cost-of-living index surged upward sharply, about 31 per cent above the 1913 level, whereas the wage index rose only by 25.6 points. The ensuing redistribution of money income in favour of the wealthier class augmented their savings which in turn became available for further government borrowing. True, the government was able to borrow large sums for war purposes, but in the end, it was the wage earners and individuals with fixed incomes who were paying the war costs and who found their consumption restricted.

The fiscal situation became exceedingly critical during 1917, and the government had recourse again to the issue of paper money. The government put into circulation $60 millions of Dominion notes, thus increasing the fiduciary issue up to $90 millions. Evidently, the income tax was bound to come, even without the pressure from public opinion, unless the government was willing to destroy its monetary system.

The Minister of Finance arrived at the income tax by trial and error, and finally conceded its necessity. Hence Dr. Michael Clark, M.P., hit the nail on the head when, commenting

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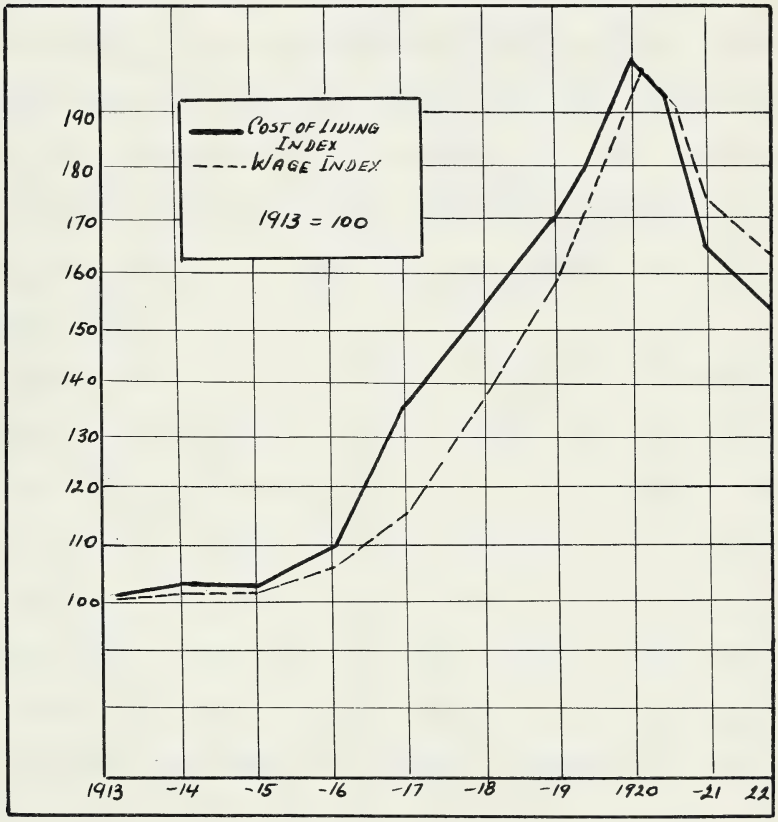
48. During the latter part of 1916 and early in 1917 the banks advanced to the Imperial Government $100 millions for purchases of ammunition, plus a revolving account of $20 million for wheat purchases; they supplied the Dominion government with 100 millions against treasury bonds; and they increased business loans by $73 millions. Cf. Royal Commission on Dominion-Provincial Relations, Report, Book I, p. 99.

CHART I.

COST OF LIVING INDEX AND WAGE INDEX

1913 - 1921[1]



1. Source : The Canada Year Book, 1921.

on the proposed bill, he said: "The war, however, has been a great fiscal school master, as well as a great schoolmaster along other lines."[49]

White's Income War Tax Act.

The bill, as introduced in the House on July 25, 1917, was passed with minor amendments. The House lowered the basic personal exemption for single persons from $2,000 to $1,500 and the Senate inserted the term "net" into the definition of income. The bill became law on September 29, 1917 with retroactive force as of January 1, 1917, bearing a title: An Act to authorize the levying of war Tax upon certain incomes (7-8 Geo. V. Chapter 28).

The Income War Tax Act as assented to was a modest piece of legislation. It comprised, on the whole, 24 sections, of which only five dealt directly with the tax liability. The remaining 19 sections regulated administrative and related matters. The evident omission of comprehensive rules in respect of deductions, etc., from the act, was supplanted by wide authority vested in the Minister of Finance who, in fact, was granted the powers to levy the tax upon incomes without any checks attached.

Persons Taxable.

The Income War Tax Act levied a tax obligation upon:

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49. Debates, 1917, p. 4640.

(1) every person resident or ordinarily resident in Canada or carrying on business in Canada in respect of his entire net income derived from whatever source (Sec. 4(10)).

(2) non-resident persons carrying on business in Canada in respect of their net income arising in Canada, the meaning on net income being restricted to the net profit or gain from a business of such a person in Canada (Sec. 3(3)).

The definition of the term "person" was satisfactorily broad so as to include individuals, corporations or any body politic or their legal representative, in which respect the Act adopted the American pattern. However, the Act was somewhat vague in imposing the tax upon non-residents who could easily escape from taxation.

Taxable Income.

Section 3 of the Act contained a positive definition of income in the following words:

> "... income means the annual net profit or gain or gratuity, whether ascertained and capable of computation as being wages, salary, or other fixed amount, or unascertained as being fees or emoluments, or as being profits from a trade or commercial or financial or other business or calling, directly or indirectly received by a person from any office or employment, or from any profession or calling, or from any trade, manufacture or business, as the case may be; and shall include the interest, dividends or profits directly or indirectly received from money at interest upon any security or without security, or from stocks, or from any other investment, and, whether such gains or profits are divided or distributed or not, and also the annual profit or gain from any other source; including the income from but not the value of property acquired by gift, bequest, devise

> or descent; and including the income from but not the proceeds of life insurance policies paid upon the death of the person insured, or payments made or credited to the insured on life insurance endowment or annuity contracts upon the maturity of the term mentioned in the contract or upon the surrender of the contract"

The definition of incomes, as outlined above, was based on the American concept of income but deviated from it on two major points. Capital gains were excluded from the scope of the Act, and further it did not contain rules for ascertaining the taxable income beginning with the gross income and going down to the net taxable income. Since the definition did not distinguish between different sources of income the taxpayer was allowed to deduct losses incurred during the taxable year from the whole amount regardless of the source with which the loss was connected. Without going into details of the complicated question of what constituted income, it may be pointed out that income in kind, e.g., the value of farmers' products consumed by him or his family, was somewhat vaguely defined, and it may be assumed that the Act implicitly excluded them from taxation although the Minister held such income as assessable.[50]

Special treatment was afforded to income received in the form of dividends, and to undistributed profits. The Act exempted the dividends from the normal tax but they were to be included in the taxable income for purposes of super-tax, which

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50. Cf. Plaxton, C.P., and Varcoe, F.P., <u>Dominion Income Tax Law</u>, Toronto, 1921, p. 149.

taxed also the shareholder's share in the distributed profits of the company above a reasonable level fixed by the Minister.

Deductions.

Two kinds of deductions were allowed under the terms of the Act: those from the tax payable, and those allowed in computing the net income. As to the former, the Act permitted deduction from the amount of the tax the whole sum which would be otherwise payable under the Special War Revenue Act, 1915, Part I,[51] as well as the tax payable under the Business Profits Tax Act, 1916, subject to certain limitations. As to the latter, the Act followed the British practice, omitting the enumeration of allowable deductions. Generally, the taxpayer was permitted to deduct from his gross receipts all the necessary expenses incurred by him in earning those receipts. The Minister was empowered to allow a reasonable amount for depreciation, and for depletion in the case of mining, oil and gas enterprises, and in addition to these also a reasonable amount for "any expenditure of capital nature for renewals or for the development of a business" (Sec. 3(a)). Due to the similarity with British rules in this matter, the English decisions as to the ascertainment of net income became applicable to the meaning of the Dominion Act.

Exemptions.

A personal statutory exemption was fixed for single persons,

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51. This deduction affected banks and insurance companies.

widows or widowers without dependent children at $ 1,500. and for all other persons at $ 3,000. the corporate bodies inclusive. No exemption was allowed for dependents, but by virtue of section 4 (1a) widows and widowers with dependent children, were permitted to claim an exemption for married persons. The statute exempted expressis verbis the income of the following persons from tax liability: The Governor General of Canada; consuls and consuls-general, providing they were citizens of the country they represented and were not engaged in another business or profession; persons who had been on active service overseas, in respect of their military or naval pay; and further, Crown companies, religious, charitable, educational, agricultural institutions and societies, fraternal and the like societies; mutual corporations; some insurance, mortgage and loan associations operating for the benefit of farmers, as well as the income derived from bonds and securities of the Dominion of Canada issued under such a stipulation.

Tax Rates.

The Dominion Act of 1917 imposed a flat rate of 4 per cent upon all incomes over and above the statutory exemptions, and in addition thereto a graduated supertax on incomes over $ 6,000. was imposed according the following cumulative schedule:

Over $	6,000	to $	10,000	2 per cent
"	10,000	-	20,000	5 per cent
"	20,000	-	30,000	8 per cent
"	30,000	-	50,000	10 per cent
"	50,000	-	100,000	15 per cent
"	100,000	-		25 per cent

Corporations and other business enterprises paid the flat tax of 4 per cent upon the income exceeding the exemption of $3,000, but were exempt from the super-tax. The statute did not discriminate between earned and unearned incomes.

The principle of stoppage at the source was applied to normal tax only. The taxpayer was obliged to fill an annual return before the end of February stating his income and exemptions claimed, and furnish upon the request of the Minister any information in respect of his income. The Minister then assessed the tax in each particular case, which was to be payable within a month from mailing the assessment notice. The taxpayer, when dissatisfied with the assessment of the Minister, could appeal to the Board of Referees, and further to the Exchequer Court.

The administration of the income tax was vested in the Minister of Finance. Although there were established district offices across the country, their authority in income tax matters was limited to collecting tax returns and amounts assessed. The assessment procedure, however, was concentrated in Ottawa in the hands of the Commissioner of Taxation.

On the whole, the Income War Tax Act was a peculiar blend of American and British principles. Its scheme and the basic philosophy is American. Indeed, there are some important deviations from American practice in favor of British experience, like the treatment of capital gains, or business deductions, which have saved the Act its distinctive independence. Thus,

from its beginning Canadian income tax practice, albeit drawing heavily upon both the American and the British system, has not followed slavishly either of them, and, in a sense, it erected a bridge between those two great systems.

The First Three Years.

The hasty move of the Minister of Finance to suspend the higher business profits tax on account of the new and lower corporate income tax was strongly criticized in the press, and when the charges were heard in the House, the Minister assured the members that the matter would be reconsidered if the fiscal necessities of the country would require it. Nonetheless, his shaky stand on such important fiscal matters nourished the controversy between the staunch supporters of steep progressivity and advocates of low personal exemptions, which went on for some time even after the adoption of the measure. But the coming federal elections with all their political consequences quieted down the polemics, and put both sides into one nest.

The Unionist government was more favorable to tax reform than the old Conservative Ministry. It included a representative of western farmers in the person of Mr. Crerar, and the official financial critic of the previous opposition, Mr. MacLean, both firm supporters of the income tax. When the latter in his capacity of Acting Minister of Finance delivered the budget speech on April 30, 1918, the new attitude was clearly discernible. His amendments to the Act broadened and deepened the impact of the income tax in accord with public demands for

higher taxes.

The basic personal exemptions were lowered to the $1,000 and $2,000 level for single and married persons respectively, but for the first time a deduction for dependents of $200 was introduced for every child under sixteen years of age depending upon the taxpayer for support. The definition of persons taxable was slightly improved, and the previous tax rates were substituted by a new, substantially increased schedule. The amending law (8-9 Geo. V. c. 25) imposed three different taxes: a normal tax, supertax and surtax. The normal tax consisted of two flat rates: a 2 per cent rate was imposed upon the income in the $1,000 - $1,500 and $2,000 - $3,000 brackets of single and married persons respectively, and a higher rate of 4 per cent upon the entire income above the upper levels. The graduated supertax began at $6,000 with a rate of 2 per cent and continued upward up to the $1,000,000 with a rate of 50 per cent over this level.[52] In addition to both normal tax and supertax the law levied a surtax which was graduated according to the size of income, but calculated on the basis of the tax payable thereon. It charged the income between $6,000 - $10,000 with a rate of 5 per cent; then for the brackets of $10,000 - $100,000 and $100,000 - $200,000 the rate was 10 per cent and 15 per cent respectively; and income over $200,000 was charged with 35 per cent of the normal tax and supertax

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52. See Appendix, Table E.

payable thereon. The rate of corporate income tax was raised from 4 per cent to 6 per cent, but the statutory exemption remained unaltered. The income of an incorporated company whose business and assets were carried on entirely outside of Canada were exempted from the tax liability.

The amending statute repealed the principle of stoppage at the source, and substantially improved the rule of information at the source. During the two years 1918 and 1919 the income tax attracted a great deal of public interest. The kaleidoscope of views and opinions ranging from a sober critique of the Act to the political agitation which found its way to the press will here be accounted but briefly.

The economic consequences of the government's excessive borrowing were fully felt by the nation toward the end of the war. On the one hand prices and the cost-of-living[53] were jumping upward by leaps and bounds, pressing on the average man; on the other hand the exemption clause of a large number of government's securities was establishing a group of privileged income receivers, and endangering the market of the securities of all private companies. It was especially The Financial Post, which at that time was in its circles as radical as the farmers, that vigorously attacked the government, and demanded that the exemption provision should be abandoned for the future.

The question of tax free securities grew in seriousness since the government was compelled to have recourse often to

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53. See Chart I, p. 67.

the domestic money market in order to secure necessary funds for the enormous war expenditures, and later on, demobilization expenditures. The public debt passed the billion dollar mark in 1918, and was expected to rise. Although the government was willing to follow Skelton's advise[54] to extend taxation policies, it was not prepared for such a task. The administration of income tax lacked an experienced staff, and consequently was far from satisfactory. People were not accustomed to the new tax, and the average man felt embarrassed by the returns he was required to submit to the Minister. Western farmers' organizations forwarded many a resolution to the Minister demanding simpler forms and instructive literature. Evasion was quite common. In the East it was done on such a scale that, as it was estimated, in the cities of Toronto and Montreal alone more people evaded the tax than paid it in the whole of Canada. But apart from these general defects, unavoidable as they were, the administration of the income tax was entrusted to a former head of customs and excise administration, Mr. Breadner, who shared the class bias of his Minister. While the assessment of the corporation income tax was treated very lightly, many assessments being postponed to an indefinite future time, the farmer was the fellow whom the income tax administration was

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54. In his second paper on public finance O.D. Skelton urged strongly the government to use more taxation and less borrowing. Cf. his Federal Finance II, Kingston, 1918.

after.[55] Improvements could come only gradually as the administration stopped flirting with politics and devoted more attention to increasing its efficiency and to eliminating loop-holes in the Act through which the big fellow or more influential man could easily escape.

On the political scene, the income tax had come again to the fore. The farmers' organizations, indignant and dissatisfied with the government, reverted to political action. On the morrow of the war truce the Canadian Council of Agriculture published a redrafted "Farmers' Platform" under the striking title The New National Policy in which it reiterated the former demands of farmers for tariff reductions, and came out with a surprisingly well rounded proposal for a revenue system based on direct taxation, viz. income tax and succession duties. The Progressive Party which was established soon afterwards adopted the New National Policy as its political platform, and faithfully supported the income tax in the parliament.

The fiscal necessities and pressure from the public pushed the government more and more closely to income taxation, for it represented the only source of revenue adaptable to further increases without evoking much criticism. The

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55. The Commissioner of Taxation boasted before the convening Dominion Association of Chartered Accountants in Montreal on Sept. 18-20, 1918: "The farmer is required to add to his income the value of goods that he and his family have consumed. And I want to say here that there have been hundreds of assessments made against farmers. The other day an assessment of nearly $5,000 was made in respect of 1917 income against the farmer."

last budget of Sir Thomas White, delivered on June 5, 1919, tasted more of politics than of economics. Tailored for consumption in the West, it cut down the tariff rates of the British Preference to their pre-war level, and introduced significant alterations to the income tax law, in respect to its incidence and applications.

Firstly, the amending law included explicitly salaries and indemnities of the members of the House of Commons and the Senate, as well as the salaries and remuneration of federal and provincial civil servants, judiciary inclusive, into the definition of income, thus eliminating whatever doubts there were as to their tax liability. The taxation of judges' salaries was, however, contested in the courts later on.

Secondly, the allowance for dependent children was extended as to apply to all dependents under 18 years of age.

Thirdly, the income tax law was given again a new set of tax rates applicable to individuals. Sir Thomas White considered the triple tax rates of the previous year too complicated, and returned to his original scheme of a normal tax and a surtax. Leaving the statutory personal exemptions of the previous legislation unaltered his law levied income tax liability upon incomes of individuals according to the following schedule:

Normal Tax: 4 per cent rate on excess over $1,000 up to

$6,000 of single persons, or over $2,000 up to $6,000 of married persons, and 8 per cent rate over $6,000 of all persons; plus Surtax:

over	$5,000 but not over	$6,000	1%
"	6,000 but not over	8,000	2%
"	8,000 but not over	10,000	3%
"	10,000 but not over	12,000	4%

and so on 1 per cent added for every additional $2,000 of income up to $100,000, then

over	$100,000 but not over	$150,000	52%
"	150,000 but not over	200,000	56%
"	200,000 but not over	300,000	60%
"	300,000 but not over	500,000	63%
"	500,000 but not over	1,000,000	64%
"	1,000,000		65%.

Fourthly, the rate applicable to corporations and joint stock companies was raised from 8 per cent to 10 per cent, and at the same time the basic exemption was lowered to $2,000. The depreciation and depletion allowance as granted in the original law to mining and oil businesses was extended so as to apply to timber limits. Further, a special provision was made regarding the taxation of dividends and shareholders' bonuses in the hands of stockholders earned prior to January 1, 1917, but distributed thereafter as follows:

> "Dividends or shareholders' bonuses paid or credited to its shareholders by a corporation on or after the first day of January, one thousand nine hundred and seventeen, shall be taxable as income of the shareholder in the year in which the same are received or credited unless paid exclusively out of a surplus or accumulated profits on hand prior to the first day of January, one thousand nine hundred and seventeen. No dividend or shareholders bonus shall be deemed to be paid or credited out of surplus or accumulated profits on hand prior to the first day of January, one

> thousand nine hundred and seventeen, if the earnings of the corporation since the beginning of the accounting period which ended in the year of one thousand nine hundred and seventeen are sufficient to provide for the said dividend and other taxable dividends paid or credited since the said date." (Section 3(3), as added by Sec. 2(4), of Chapter 55, 1919).

By the same Act a deduction from the tax payable was granted on account of income taxes paid to Britain or her colonies or dependencies, and to any foreign country providing that the country allowed the same privilege to Canadian companies, and that the amount deducted was not exceeding the amount of the tax which would be otherwise payable under the Canadian statute.

The deplorable state of business management of a big majority of Canadian companies induced the Minister to impose a statutory obligation upon every taxpayer, chiefly companies, to keep adequate records and books of accounts for income tax purposes.

Fifthly, a set of fines and penalties was inserted into the income tax law to assure compliance with its provisions. A penalty of 25 per cent of the tax payable was imposed for not making a return in the case of a taxpayer, and a fine of $10 for each day during which the default continued in the case of other persons required by the statute to file a return on behalf of third persons. The failure to pay the assessed tax within a month from the date of notice was subject to a penalty of 5 per cent of the assessed tax plus one per cent thereof for each

month during which the default continued. The default in keeping adequate books of accounts was charged with a fine of $100 for each day during which the default continued.[56]

The effects of these amendments were noticeable when the returns for the 1919 taxation year began coming to the Department. The amount of tax collected jumped from $9,000,000 to $20,000,000. The personal income tax netted over $4 millions more than in the previous year, whilst the corporate tax yield increased from $1.3 millions to $7 millions.

The income tax, although intended as a war measure by the Minister of Finance was gradually gaining ground and recognition. The complaints coming from the public at large reflected more or less the initial difficulties which the administration had to cope with, but by no means aimed at the tax *per se*. The changing attitude was, perhaps, most remarkable with the former opponents of income taxation. They recognized the fact, that the tax exercised indirectly favorable influence upon the economy and business practices. As the *Journal of Canadian Bankers' Association* stated editorially:

> "The income and profit taxes which have been the distinctive feature of war finance bid fair to work a revolution in business accounting practice. Income

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56. The budget of 1919 reintroduced the business profits tax and at the same time altered the rates on excess profits.

> tax assessors declare they have been amazed to find how few business men operating a moderate capital really know their exact financial position. Only rudimentary accounts are kept, or the books are not closed, or stock is not taken, or no outside audit provided. The law's compulsion is bringing about what the banker's urging too often failed to secure - the adoption of modern and accurate accounting methods. The advantage to the business man himself, and incidentally to his banker, will be very great....
>
> Another result, which might more easily have been anticipated, is that in the balance sheets of the larger corporations the demand of the conservative accountant are heeded at least. The adequate allowance made for depreciation, obsolescence or amortization, the vigilant pruning of inventory totals, the strict valuation of 'souvenir' assets, and the prudent provision for probable liabilities, produce a balance sheet which.... is a joy to behold." 57

Evidently, we could refer to more similar references to prove that the skeptical and apprehensive opposition to income taxation was gradually fading away during the first three or four years of its existence. By all means, the tax had come to stay not only because of fiscal needs, but also because the majority of the tax-paying public was favoring it. However, the question of its exact place and its relative importance in the federal revenue system were yet left open, and the tax had to go a very long way till it became a chief and permanent factor in Dominion public finance. But this brings us to another chapter of the history of income taxation in Canada.

A Resume.

We endeavored in this chapter to frame the early history

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57. The Journal of Canadian Bankers' Association, Vol. XXVII, October, 1919, p. 19.

of Canadian (federal) income taxation into the broader lineaments of the social and economic growth of Canadian society. But having singled out some peculiar characteristics of this development we have deliberately refrained from drawing definite conclusions, for such an attempt would have led us into an extensive study, transgressing the borders of a limited treatise on public finance. Indeed, this is not to say, that a comprehensive study of the subject matter could neglect these aspects. May we frankly admit here that the peculiar association of the agrarian class with direct taxation, characteristic to both, the Canadian and American history of income taxation, led us to a careful reconsideration of various theories of social and economic development.

As a thesis we have deliberately put the Conservative National Policy Program, and then we followed the development of the antithesis[58] - the agrarian opposition to this Program. At the early stage the farmers' reaction was more or less negative, namely, they strove for removing the injustice of the existing fiscal system. Only when the Laurier Ministry failed to fulfil its promises, did the farmers revert to a positive action which gradually culminated in adopting direct taxation - an antithesis - as their idea of a just fiscal system. During this fermenting stage, marked by a lively controversy between the farmers and the industrial capitalist class, a strong influence of British and American fiscal ideas is clearly discernible.

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58. The terms of the Hegelian concept of social development are used here strictly as an easy mode of illustration, and by no means do they indicate our adherence to this philosophy.

A specific reference must be made to the support given to the Canadian free trade movement by the writings of Edward Porritt, a British Cobdenian Liberal.

The year of 1910 witnessed the first break with the past. The farmers' revolt against the tariff and their decision "to face" direct taxation in whatever form was, in a way, a revolutionary act. What they understood under the term of direct taxation amounted more to a land tax of Henry George's type than to a graduated income tax, although the latter was not explicitly ruled out. Only after the southern republic adopted a graduated income tax did the progressive western forces come out with a clear demand for such a measure. In the meantime, the war developed and by exposing the shortcomings of a one-sided fiscal system, played into the hands of the agrarian income tax movement.

The indifference of the Conservative Party, then in power, towards any fiscal reform drove the agrarians into politics. Dr. Clark's persistent proposals of a federal income tax received a marked support from the Canadian Council of Agriculture which in 1916 published a redrafted Farmer's Platform whereby the agrarian demand for a progressive income tax was explicitly stated. Three years afterwards the same demand became a major plank of the Progressive Party established and fostered by agrarian interests.

The war, however, focused the interest of Canadian scholars of economic science on public finance, and to nobody's surprise

they supported the progressive ideas of the agrarian class. Professor A. B. Clark of the University of Manitoba, and Dr. O. D. Skelton of Queen's University publicly backed the drive for a federal fiscal reform. By this time, the question of income taxation attracted supporters from all strata of Canadian society, businessmen, farmers, scholars and politicians, so that the Minister of Finance was compelled to defend his fiscal policy in each successive war budget. But while agreeing in principle with advocates of an income tax, he adhered to the easy mode of war financing, namely, borrowing, which was well fitted to please his protectionist and profiteering followers.

The first concession made to public criticism was in the form of taxing the excess war profits. This opened the door to the introduction of a graduated income tax, and everything signalized its incorporation into the budget of 1917. The failure of the Minister of doing so was more or less attributable to the influence of big business which feared the tax for obvious reasons. Only when the conscription issue necessitated a federal election and the government anticipated defeat, did the Minister reconsider his stand and finally introduce the tax in order to woo the farming electorate.

The adoption of the tax, even in a mild form, prepared the ground for the Unionist government, and by all means represented a victory of the progressive forces. Here we have the synthesis of the preceding development, which, perhaps

was best expounded in the New National Policy Programme, adopted by the Canadian Council of Agriculture in 1919.

During the first three years of its existence, the income tax convinced many of its former opponents of its favorable effects and greatly dissipated the apprehensiveness of uninformed business circles. Even the Conservative party, which at the beginning, considered the tax to be its unwanted child, changed its attitudes in the postwar period, and looked at it with a more favorable eye.

The great metamorphosis which the federal system of taxation underwent during the first two decades of this century may be, perhaps, best illustrated by the stand taken by Sir George Foster, the co-author of Conservative National Policy. After about forty years of its existence, Sir George evaluated the change as follows:

> "We have had two systems of taxation, one almost predominantly up to the present time, and that is the method of indirect taxation, by which the people paid heavily and did not know when they were doing so....I doubt if that system of taxation, altogether imposed upon a country, is a good schoolteacher to that country and does eventuate in what is best for the interest of the people....Now we are working up along the line of direct taxation every year a little further and yet not by too violent advances that would produce - I would say a revolution, but that word does not convey my meaning - but a reaction against that principle of taxation." 59

Definitely, the Canadian system of taxation underwent a fundamental change within the first two decades of this century. The forces which brought about this change originated in the great social and economic upheaval which spurred the whole

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59. Debates, 1920, p. 2514-14.

Western civilization from a liberal democracy to an egalitarian democracy staffed with all the socialist or welfare institutions which are a vogue in to-day's politics. The progressive income tax prepared ground and became one of the mainstays of this new political system.

CHAPTER III.

THE INTER-WAR PERIOD

Drayton's Income Tax Legislation.

The last budget of Sir Thomas White served as cause for western agrarian members of Parliament to break with the Unionist government and to cross the floor of the House. The augmented opposition as well as the repeated criticism in the press of White's irresponsible and discriminatory financial policy induced a switch in the portfolio of finance. In the fall of 1919 Sir Henry Drayton was commissioned by the Prime Minister to a difficult task: to repair past mistakes and to pilot the country's economy during the period of adaptation to peace-time conditions.

The country soon noticed that it had a capable Minister in charge of its finances. The third Victory Loan was floated without the bait of tax exemption, and the first budget of Mr. Drayton, brought down in May, 1920, marked a definite break with the recent past. "The duty of today," Mr. Drayton told the House of Commons, "is to carry on the government of the country without any additions to the debt, but on the other hand to promote measures which will reduce the country's obligations"[1], which indicated that the government had abandoned the easy way of procuring funds and that it intended to rely upon taxation. Accordingly, the minister introduced a new tax on consumption -

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1. Debates, 1920, p. 2476.

The General Sales Tax - and proposed sweeping amendments to the Income War Tax Act and Business Profits Tax Act.

He was aiming at the core of the problem when he stated that under the existing acts the system of assessment and collection of taxes was entirely unsatisfactory, and was causing vexatious delays. Although in the amendment of the acts he proposed an over-all increase of tax rates, it was chiefly designed to secure the revenue the Treasury was entitled to, and to eliminate the widespread evasion and avoidance of the tax.

The most significant innovation was the new system of assessment. Under the original law the taxpayer submitted to the minister a statement showing his net income for any particular year, and waited with payment of the tax until the department sent him the official assessment. Drayton's law made every taxpayer his own assessor in the first instance. The return forms were furnished with tables of tax rates for each income bracket as to enable the taxpayer to compute his tax liability, 25 per cent of which became payable on mailing the return to the district taxation office, and the rest to be defrayed by three subsequent instalments.

The effectiveness of this system was guaranteed by drastic penalties for a mistatement of income. If the underestimate did not exceed 10 per cent of the net income, the taxpayer was charged with a penalty of 10 per cent of the omitted amount; if the omission was over 10 per cent but less than 20 per cent,

the penalty amounted to 50 per cent of the hidden sum, and an understatement of 20 per cent or over was charged with a 100 per cent penalty of the omitted income. Perhaps nothing better proves how the taxpaying public had been nursed by the previous minister than the necessity to impose such numerous and drastic fines which, when added to the existing ones, made the Act look like a penal code.[2]

The definition of persons liable to tax was entirely re-

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2. A book of instructions issued by the Royal Trust Company of Canada for its clients described the duties and penalties of the Income War Tax Act as follows: "The citizen must not wait till he is asked for his tax; nor may he leave the calculation of this amount to the officials. He must calculate it himself and pay it without being asked. Along with the form showing his income for 1920 he must send in (by April 30, 1921) at least one-fourth of the actual tax which he reckons himself liable for, the rest being payable later with six per cent interest in three monthly instalments.

If he puts the figures too low he becomes immediately liable to several penalties, even if error is unintentional...

For instance: if he underestimates his income by a trifling amount, up to one-tenth, he must pay income tax on the deficiency with ten per cent interest. If he underestimates his income by more than ten and less than twenty per cent, the fine is one-half the amount of the income omitted - not merely one-half of the tax. If the deficiency is twenty per cent or more the whole of the unreported income is taken. Thus if he states his income as \$4,500, when it is \$5,650, he is fined \$1,150, besides of course, the unpaid tax.

If he is late in sending in his return twenty-five per cent is added to his tax.

If he pays less than a fourth of the tax as estimated by himself to begin with, or less than the proper amount in the case of later instalments, twenty-five per cent, of the deficiency (and in no case less than \$5.00) is added to his tax. The same penalty is prescribed for not paying within thirty days any sum demanded in addition to the tax as estimated by himself.

If he is asked for further information and is late in sending it, or if he fails to keep such adequate records and accounts as the Finance Minister may prescribe, he may be fined \$100 a day for his default; and a false statement may be punished with a \$10,000 fine and six months in jail." (Quoted by Mr. Fielding in his budget reply, Debates, 1921, p. 3148.)

drafted. The statute imposed a tax upon every person:

1. residing or ordinarily resident in Canada; or
2. who remains in Canada during any calendar year for a period or periods equal to 183 days; or
3. who is employed in Canada; or
4. who, not being a resident in Canada, is carrying on a business in Canada; or
5. who, not being resident in Canada, derives income for services rendered in Canada to any person resident or carrying on business in Canada....

Resident persons were charged with a tax upon their entire income irrespective from whichever source derived, while non-residents were obliged to pay the income tax only upon that part of their income which originated in Canada. The statute defined in detail the duties and obligations of trustees, assignors, executors, and like persons in respect of their making up returns and paying the tax on behalf of third persons.

Drayton's amending law introduced three alterations regarding the computation of net income. Firstly, stock dividends became explicitly taxable income; secondly, the income from an estate or an accumulating trust was liable to tax for the first time; and thirdly, the deduction granted under the original law for contributions to the Patriotic Fund or other war funds was repealed.

The structure of tax rates remained unaffected, but the amount of tax payable was increased by 5 per cent on incomes exceeding $5,000.[3]

Despite the drastic penalties the amending Bill was adopted without any significant criticism from either side of the

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3. Cf. Statutes of Canada, 10-11 Geo. V., c.49.

House, and having been put into effect it did fiscal wonders. The revenue from the income tax field multiplied by 80 per cent as against the previous fiscal year. The personal income tax yielded $32.5 millions (an increase of $12.5 millions), and the corporate income tax netted $13.8 millions, $6.8 millions more than in the preceding year.

However, opposition to the income tax was in the making. The inquisitorial methods of assessment and collection aroused a wave of protests not only from members like Mr. Currie who placed himself on record as being entirely opposed to the income tax, but also from the staunch supporters of the tax. Mr. Fielding, speaking for the opposition, took strong exception to the methods employed by the Minister in collecting the income tax revenue. In his reply to the Budget Speech in May, 1921, he stated that:

> "The complaint of today with most of the people paying the income tax is not with the tax itself. The tax has to be paid, although it is a burden. But the penalties which my hon. friends are imposing in their efforts to get money are the cause of much vexation, and give just cause for complaints. I recognize the fact that the Minister of Finance, like any other creditor must... exercise a little pressure... but I do not think he is justified in out-shylocking Shylock by charging 60 per cent interest to the poor devil who fails to pay promptly..."[4]

Similar protests were voiced throughout the spring session of parliament from both sides so that Mr. Drayton under such pressure and in view of coming elections felt compelled to smoothen

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4. <u>Debates, 1921</u>, p. 3147.

the progressivity of tax penalties. Toward the end of the session he introduced a bill which imposed a floor on the penalties enacted a year ago.

From a strict economic viewpoint Drayton's fiscal measures would deserve some criticism, if not for the fiscal necessities which chiefly dictated their course. The government was raising the tax level in a period of decreasing economic activity, and in addition to that, the strict penalties put business and enterprise under the tax press in respect of both current taxes and arrears, in some cases as far back as 1916. This probably influenced the economic slump which hit Canada towards the end of 1920.

Indeed, the serious efforts of the Minister of Finance to liquidate the over-due taxes backfired during the election campaign. The famous Riordon case weakened the Conservative platform of economic nationalism, and the opposition was given mighty arguments of government's favoritism of big business. [5]

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5. The Riordon Company, which was in the public spotlight in 1920 when they completed a spectacular merger and reorganization, was assessed in 1921 for all the previous years back to 1916. On account of financial difficulties the company offered the government a promissory note in lieu of a cash payment of all due taxes amounting to $ 800,000. Mr. H. M. Ellard, progressive candicate in Wright County, fired the first shot at the government in a letter addressed to the Prime Minister, asking if similar privileges would be afforded to every taxpayer who happened to be in financial difficulties. The case became an election sensation of major dimensions, and to a great degree influenced the electorate against the government.

The consolidated Income War Tax Act represented quite an achievement. Income taxation reached its peak as to rates and to income radius, for the whole period between 1917 and 1933.

<u>The Income Tax Under the Liberal Administration.</u>

History teaches us that we have to distinguish between the Liberals in opposition and the Liberals at the government's reins. Prior to 1896 they bitterly attacked the National Policy, then for fifteen years followed its line. The situation repeated itself also in the case of income taxation. When they were on the left side of the House, Parliament heard many able speeches on the income tax. However, once they assumed power the income tax was in peril. Around 1927-28 the King Ministry made no bones about their willingness to abolish the tax entirely, after they had reduced it almost to a nominal tax by systematic lifting of the level of the tax-exempt income.

The first step in this direction was taken by the old and now the new Liberal Minister of Finance, W.S. Fielding, in 1922. The allowance for dependent children was raised from $200 to $300, and married persons supporting a parent, sister, daughter or son received an additional exemption from the normal tax only up to $2,000.[6] The allowances for dependent children were further increased up to $500 in 1924.[7] Economically speaking,

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6. <u>Statutes of Canada</u>, 12-13, Geo.V, c.25.

7. <u>ibid.</u>, 14-15 Geo. V, c. 46.

these steps were justified. The government aimed during the slump to provide relief to persons particularly in the lower brackets, and by exempting incomes of larger families it favorably influenced the level of consumption, and thus employment.

Drayton's income tax statute did not eliminate the wide possibility of tax avoidance, and it was left to the new administration to cope with the problem. The amending legislation introduced in the 1923 session contained some new important provisions. Firstly, it inserted a regulation into the statute providing that "in any case the income of a taxpayer shall be deemed to be not less than the income derived from his chief position, occupation, trade, business or calling... and the Minister shall have full power to determine the chief position, occupation, trade, business or calling..."[8] This amendment restricted the freedom of the taxpayer to charge losses, expenses or other deductions against the whole amount of income as allowed under the original White law. Consequently, the wage and salary receivers could not make any other deductions from their incomes save those allowed by the statute.

The wave of bankruptcies and business failures between 1921-23 entangled the collection procedure considerably, and in some cases the treasury lost potential revenue. The government decided to protect the public interest and effected a

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8. ibid., 13-14 Geo. V, c. 52.

drastic measure which was met with similar opposition as Drayton's penalties. The statute of 1923 made the tax liability a prior secured lien on the real property of a taxpayer. It meant that the tax debt had priority over all other liens attached to the real property and followed it even when it switched hands. The measure curtailed the borrowing on real property so considerably that the government felt it necessary to repeal it in 1925.[9]

The third important amendment affected the appeal procedure. The provision regarding Boards of Referees was never put into operation, and in 1923 was repealed. The taxpayer was, however, allowed to demand a review of his assessment by the Minister, and if still dissatisfied, he could appeal directly to the Court of Exchequer.

The income law was further altered in 1924, the main provisions being concerned with inter-company transactions, partnerships, the income of non-residents arising from partial carrying on of business in Canada, and the undistributed income of wound-up companies.

According to the amending statute of 1924 the inter-company transactions were to be valued at the fair market value, and the Minister could determine the fair price at which purchases were to be taken into the accounts of the company. Secondly, the income of partnerships became liable to tax in

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9. The prior lien regulation was in force after Jan. 1, 1924 for a little over a year.

the hands of partners in the year in which it arose irrespective whether or not it was distributed among them. In the case of husband and wife being partners in any business the minister had full discretionary powers to rule how such income should be treated and taxed accordingly. Thirdly, the income arising partly from carrying on business within Canada (e.g. a non-resident company operating a mine in Canada, but processing the raw material abroad) was liable to tax in a proportion as the minister deemed to be a true part earned in Canada.

Prosperity was in full swing in 1926 so that the government deemed it desirable to give way to the insistent demands for tax reductions. J.A. Robb, the Minister of Finance, referring to these demands stated that "happily, our financial and commercial position now enables us to make very substantial reductions in the income taxes.... The Act is now presented in a new and less complicated form, one which will make it easier to calculate, and, we believe, easier to pay."[10]

The salient feature of Robb's amendments was the remarkable shift of the tax burden from individuals to corporate profits or business profits. Individuals were granted wider exemptions and lower tax rates, and, at the same time, incomes from personal and family corporations became taxed more heavily, the principle of double taxation introduced, and a host of other amendments made tax avoidance a much more strenuous pastime. To

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10. Debates, 1926, p. 2457.

be sure, the corporate tax rates were reduced as well.

The statutory exemptions jumped from $1,000 to $1,500 and from $2,000 to $3,000 in the case of single and married persons respectively. The allowance for dependents remained unaltered. Married status was broadened as to include an individual (1) "who at his own and sole expense maintains a self-contained domestic establishment employing therein a full-time housekeeper or servant, or (2) who maintains a self-contained establishment and who actually supports and maintains therein one or more individuals connected with him by blood relationship, marriage, or adoption". Husband and wife with separate incomes in excess of $1,500 could claim the $1,500 exemption each, and they also could arrange between themselves the exemptions for dependents.

Mr. Robb repealed the old rate structure along with the 5 per cent additional tax, and introduced only one mildly progressive rate schedule. It was designed to ease the total tax liability as well as to simplify its computation.

The new tax rates applicable to individuals ran as follows:

On the first $2,000 or any part thereof 2%;

on the amount in excess of

$2,000 but not in excess of	$3,000	3%
3,000 but not in excess of	4,000	4%
4,000 but not in excess of	5,000	5%
5,000 but not in excess of	6,000	6%
6,000 but not in excess of	7,000	7%
7,000 but not in excess of	8,000	8%
8,000 but not in excess of	9,000	9%

and so on adding 1 per cent to the preceeding rate for each additional margin of $1,000 up to $20,000; then for each additional

margin of \$ 5,000 up to \$ 100,000; and on the amount in excess of

\$100,000 but not in excess of	\$110,000	37%
110,000 " " " " "	120,000	38%
120,000 " " " " "	130,000	39%
130,000 " " " " "	140,000	40%
140,000 " " " " "	150,000	41%
150,000 " " " " "	175,000	42%
175,000 " " " " "	200,000	43%
200,000 " " " " "	250,000	44%
250,000 " " " " "	300,000	45%
300,000 " " " " "	350,000	46%
350,000 " " " " "	400,000	47%
400,000 " " " " "	450,000	48%
450,000 " " " " "	500,000	49%
On the amount in excess of	\$500,000	50%.

The progressivity of the tax was further smoothed by the rearangement of income brackets. For example, the tax liability of a single person receiving income of \$8,500 amounted to \$290, or about 4.1 per cent of the taxable income.[11] Corporations and joint stock companies paid a 9 per cent tax rate on their income in excess of \$2,000.

Robb's amending statute of 1926 explicitly stated that dividends, income of personal corporations and family corporations were taxable in the hands of shareholders. But shareholders of a family corporation were allowed to elect by notice in writing to the Minister to be assessed either as a corporation or as a partnership. Since company earnings were subject

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11. The computation of the total tax liability on an income of \$8,500 of a single person was as follows:

Exempted income	\$ 1,500
Taxable income	\$ 7,000

On the first \$ 2,000	2%	\$ 40
On additional 1,000	3%	30
" " 1,000	4%	40
" " 1,000	5%	50
" " 1,000	6%	60
" " 1,000	7%	70
Total taxable income \$ 7,000	Total Tax	\$290.

to corporate income tax, and when paid out to shareholders they were liable to the personal income tax, the problem of double taxation became for the first time of importance in Canadian income taxation. It was done so on purpose in order to tax investment income more heavily than earned income, which definitely represents an interesting argument in favour of double taxation.

The problem of how to catch into the tax net the various forms of corporate dividends has kept busy the ministers of finance since the days of Sir Henry Drayton. As may be remembered, he introduced a provision of 1920 making stock dividends subject to tax. Since then the hide-and-seek play between the administration and the taxpayer has continued, which, as Dr. Petrie remarks, was never entirely successful from the former's viewpoint, and resulted in a considerable complication of the tax law.[12]

Sir Henry Drayton drew to the attention of his Liberal successor that the problem of personal corporations was becoming of concern to him during the latter part of his administration and urged the new minister to introduce legislation on the matter. The question was taken up partially only in 1924 when the Acting Minister of Finance, Mr. Robb, added a section to the tax law providing that "on the winding up, discontinuance or reorganization of the business of any incorporated

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12. Petrie, J.R. <u>The Taxation of Corporate Income in Canada</u>, Toronto, 1952, p. 54.

company, the distribution in any form of the property of the company shall be deemed to be payment of a dividend to the extent that the company had on hand undistributed income". This section solved only a small part of the problem, and was more or less intended to counter the decision of the English Court of Appeal (Inland Revenue Commissioners v. Burrell) that undistributed income allotted to shareholders on the winding up of a company represented a distribution of company's capital, and as such was not taxable.

The Minister did not touch the problem until 1926, when at one stroke he made the variety of shareholder's receipts subject to income tax, save the inter-company dividends. To eliminate this avenue of avoidance the statute had a specific provision in respect of holding companies as follows:

> "Where a person owing shares of a corporation transfers shares or a portion thereof to a second corporation acting as his agent, trustee or attorney or promoted at his instance or controlled by him, which second corporation subsequently receives a dividend from the first-mentioned corporation and applies the income thus received in whole or in part, directly or indirectly,
>
> (a) in payment of the shares purchased by the second corporation from such person;
>
> (b) in discharge of any liability incurred to such person by reason of and in connection with the purchase of such shares; or
>
> (c) in the discharge of a loan obtained by the second corporation for the purpose of paying for such shares, then such person shall be taxable in respect of such dividend as if he had received it in the year that the first-mentioned corporation

declared dividend."[13]

To block tax avoidance by means of various forms of recapitalization of the company, the law of 1926 incorporated specific provisions in respect of taxation of undistributed income. Section 8 instituted that any distribution or advance from a company to a shareholder, whether in the form of readjustment of capital stock, or capital stock reduction, or stock redemption at premium, if the company had undistributed income on hand, was subject to tax in the hand of the shareholder to the extent of the amount of undistributed profits. The dividend became taxable in the year during which the company either reduced its capital stock or redeemed its shares at premium. Further, when a company loaned money to a shareholder, except if such a loan was made incidental to the business of the company or it was its chief business, the advance was deemed to be taxable as if it were a dividend.

Another three smaller provisions were enacted in 1926. First, carrying charges or expenses of unproductive property or assets acquired for the purpose of business or liability not incurred in connection of earning income were not deductible. Second, the income of non-resident operators of ship or aircraft were exempted from the tax liability providing that the country of their residence granted similar exception to Canadian citizens. Thirdly, any transfer of property between

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13. In the original budget proposal this provision was to be limited to the first three years.

parent and child or husband and wife did not exclude the tax obligation of the transferor in respect of income arising from the property, unless the Minister was satisfied that such a transfer was not made for the purpose of tax evasion.

The Revision of the Income Tax Law.

In 1927 the Income War Tax Act of 1917 was entirely re-arranged and rewritten, although without any material change, and appeared as Chapter 97 of the Revised Statutes of Canada. The law contained 82 sections divided into eleven parts and two schedules. The titles of the parts were as follows: I- Taxable Income; II- Excepted Incomes; III- Charging Provisions; IV- Special Provisions Relating to the Incidence of the Tax; V- Returns; VI- Payment of Tax; VII- Assessment; VIII- Appeals; IX- Remedies of Crown to Recover Taxes, etc.; X- Administration; XI- Offences and Penalties. The first schedule comprised the tax rates applicable to individuals and corporations as well; the second schedule prescribed the form of the notice of appeal from an assessment by the Minister of National Revenue.

A parallel of the revised statute with the original White Act reveals the immense progress that marked income tax during the first decade of its duration. Albeit the basic features and the original structure of the law were hardly affected, it had been greatly deepened in detail and refined in wording. The incidence of the tax was gradually shifted more to investment income by eliminating the loop-holes through which some

forms of corporate distributions escaped; non-resident persons were subjected to tax obligation; and the administration of the Act noted some improvements as well. However, there were yet many shortcommings awaiting consideration. They were dealt with during the subsequent decade.

The last three years of the twenties did not bring any material changes in the law. The tax rates were cut by a flat 10 per cent in 1927 and then again in 1928, when the allowance for dependents was also extended as to apply to dependents over 21 years of age if they were incapable of self-support on account of physical or mental infirmity. In the corporation tax a provision was adopted permitting a split of the depletion allowance in cases of mines, gas, oil wells and timber limits between the lessor and lessee. In 1929 no changes occured.

A New Administrative Agency.

Until 1924 the Minister of Finance exercised the administrative authority over the income tax. In that year the administration of all revenue acts was concentrated into one agency, the Department of Customs and Excises. Three years thereafter the Department was thoroughly reorganized and assumed its present name, the Department of National Revenue. This reorganization effected a switch in the position of the Commissioner of Taxation: Mr. Breadner was transferred to customs division and his successor became Mr. C.S. Walters, former head of the District Taxation Office in Hamilton, Ontario.

Mr. Breadner's ten years of administration of the income tax

law were hardly satisfactory. Criticism and complaints not only from the taxpaying public but also from the expert professions heaped up year after year. The wide discretionary powers and the supercautious secrecy became the most criticized features of the law. Discrimination in favor of wealthier taxpayers was noticeable from utterances of the Commissioner and from the amendments affecting appeal procedure as well. The provisions respecting the Boards of Referees and publication of regulations remained a dead letter, and the former were repealed in 1923. Instead, the taxpayer was granted the dubious privilege of having his assessment reviewed by the department upon notice, and then he could contest the assessment before the Court of Exchequer, and the Supreme Court of Canada. But due to the considerable expenses involved, very few taxpayers used this legal remedy.

Between 1921 and 1926 the income tax amendments were not announced in the budget speech of the Minister of Finance, as has been customary with all fiscal proposals. Every year, a few days before the close of parliamentary session, as the Editor of the Chartered Accountant complained early in 1925, when legislators were tired and perspiring, a batch of minor amendments appeared in the form of a Bill, and these went through - as was doubtless the intention - without time being allowed for examination by those most concerned, namely - the suffering public.[14] Furthermore, there was a serious lack of

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14. Cf. The Chartered Accountant, vol. XIV, January, 1925, p. 257.

any clear income tax policy, the amendments being more or less dictated by special cases as they had arisen, or by the demands of the public at large.

The situation concerning the departmental rulings and regulations was likewise deplorable. Despite the fact that at each subsequent annual convention the Dominion Association of Chartered Accountants[15] and the Citizens' Research Insitute of Canada[16] passed resolutions demanding the publication of regulations in income tax matters, The Commissioner of Taxation disregarded these demands, and established that autocratic administrative tradition which characterizes the whole period of Income War Tax Act.

The Committee onPublic Accounts held some hearings in 1925 on the administration of income tax under the pressure of Progressive M.P's. Although the Commissioner revealed to them some disturbing facts, the parliamentarians were not permitted to look behind the curtain of secrecy, and they found out that neither did the Auditor-General enjoy the confidence of the Taxation Division. Mr. W.C. Good, a Progressive, attempted in vain to secure assent from the House of Commons for the Committee on Public Accounts to investigate the administration of war taxes. In June 19, 1925 he introduced a resolution in the House of Commons in this repect, and substantiating its necessity, he vigorously attacked the Commissioner

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15. Ibidem.

16. Cf. Minutes of Proceedings, Citizens' Research Institute of Canada, Annual Conventions, 1923-1931.

of Taxation and the whole set-up. In particular he made the following charges: (1) that the Commissioner of Taxation was formerly a tariff officer of the Canadian Manufacturers' Association; (2) that not a single one of some 30,000 assessments made under the Business Profits Tax Act had been pressed in appeal; (3) that no member of parliament nor any committee of parliament had had the privilege of examining any original assessment or any modification thereof; (4) that the Commissioner under pressure from the public for hearings before the Board of Referees made representations to the government to have the board abolished; (5) that all the officers were outside of the Civil Service Commission, and even the practice of advertising for applications was not followed; (6) that there was a considerable dissatisfaction with the administration; and (7) that the assessment and collection under the Business Profits War Tax Act was not completed until 1925. Then he continued:

> "The Commissioner has also admitted and defended deliberate delay in issuing the final notice of assessment in some cases where firms were in financial difficulties. By reasons of such delays there have been unknown and indeterminable losses of revenue; either by loss of interest or due to intervening bankruptcies."

Despite his very sane proposal that the Auditor-General should have a power to audit the Taxation Division, the resolution was killed in the House, for, neither Conservatives nor Liberals wished to have such an investigation carried into effect.

The big scandal in the Department of Customs and Excises,

divulged by Conservatives in the subsequent year, together with growing dissatisfaction over the income tax administration, necessitated a complete reorganization of the existing agencies collecting revenues. The Department of National Revenue came into existence, having the authority to administer all federal revenue acts, the income tax act inclusive.

The Income Tax Controversy Goes On.

The clamor of industry for cuts in war taxes which later wound up in a straight demand for abolition of income taxes was stimulated more by non-economic than economic aspects. The total revenue from war taxes exceeded the customs and excises revenue only in 1922, that is, after the introduction of sales tax which was welcomed by business and industry and lauded as superior to the income tax. The benevolent administration of both major war taxes, the income tax and business profits tax, removed any hardships which the taxes could effect, if administered rigorously. Albeit it is true that the Canadian fiscal system as a whole was becoming rapidly a serious problem to the taxpayer, the income tax *per se* did not hold at that time such an important place as to cause any serious hampering of economic activity.

The explanation of the opposition toward the income tax during the twenties on the side of business and industry rests, perhaps, with the unsettled social and political conditions at home and with the commercial policy of the United States. On

the one hand, the income tax represented a major plank of the fast-rising Progressive Party, which swept away the old political parties from the provincial scene in Ontario and in the West. After the federal elections in 1921 it became a balancing force in the Dominion Parliament, threatening the walls of protection. At the same time, the Canadian businessman looked with envy to the south, where the new Republican administration was favouring his fellow- entrepreneur and competitor with tax cuts and highly protective tariffs. Small wonder that he expected a similar treatment from his government.

In 1921 the drive for tax reduction was well under way. The Canadian Manufacturers' Association waited upon the Dominion Government towards the end of February and submitted numerous recommendations in respect of the government's fiscal policy. It demanded in particular that the duplication of taxation between the Dominion and the provinces should be avoided as much as possible, that the income tax should not be collected from farmers, and repealed as regards to corporations. They also proposed an increase of the sales tax as to make up for the loss of revenue. Similar demands were reiterated by a joint conference of the Dominion Retail Merchants' Association, the Canadian Credit Men's Trust Association, the Wholesale Grocers' Association, and the C.M.A. held a month later in Toronto. But they achieved very little, for the government, expecting elections, did not want to introduce any

major fiscal changes, and they had to satisfy themselves with the termination of Business Profits War Tax Act.

The abortive suggestion to replace corporate taxes by an increase of sales tax was met with the opposition of the farm press. The pre-election and election controvery as to who does pay taxes, and particularly income tax, became a favorite topic of The Financial Post, and one of the arguments against the income tax, repeated year after year, when the budget was brought down. Behind the argument was the implicit invective that the agrarian group defended the income tax from purely egoistic reasons, for it fell mostly on other classes.

TABLE III.

Income Tax Paid by Individuals and Corporations by Occupational Groups, Fiscal Years 1921-22, 1922-3

Occupational Group	1921-1922		1922-1923	
	No. of Taxpayers	Amount Collected	No. of Taxpayers	Amount Collected
Individuals:				
Farmers	18,841	1,299,104	8,220	473,049
Professionals	17,139	2,642,585	19,023	2,663,900
Employees	207,263	17,123,446	208,360	15,529,949
Merchants	23,716	7,140,101	21,168	5,474,256
Manufacturers	1,629	2,472,549	1,732	890,261
All others	21,966	9,084,549	22,661	7,355,971
Unclassified		824,788		
Total	290,584	40,471,007	281,164	31,689,393
Corporations	8,286	38,863,758	6,010	28,022,145
Less Refunds		994,458		
NET TOTAL		78,684,355		59,711,538

Source: D.B.S., Income Tax Collection Statistics.

As Table III shows, the bulk of individual income tax revenue came from the incomes of wage and salary earners, simply because their incomes were reported to the government, and fully assessed. In all other occupational groups tax evasion and avoidance must have been a common practice, for there is no other explanation for the exceedingly low number of merchants, professionals, and farmers as well, paying the tax. Evidently, the argument used against the farmers' representatives was one-sided, and might have been applied to the protectionist business group as well.

The simple evidence of tax evasion was often used by the opponents of Progressives who defended the tax against their suggestions of increasing the tax revenue. The editor of the Financial Post wrote in May, 1923:

> "The graduated income tax has been one of the most equitable of all forms of taxation. No doubt it is - in theory. But it is one thing to impose the tax and another to collect it. And this is particularly the case where every man is his own assessor.... As a matter of fact, experience in Canada is showing that when it comes to a conscience tax, the average conscience is a pretty conventional affair.... A great deal is heard from farmers and more from the politicians who cater to them about the tariff and other tax burdens but the figures indicate that the wage and salary earners are really paying the levy and making no fuss about it. They and the corporations are supplying the great bulk of the tax funds to finance the country... Canada wants a tax which will be equitable in operation as well as in theory. The income tax as it is now operating is not such a tax." 17

Along with these popular objections to the income tax, there were from time to time echoed more specific strictures,

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17. The Financial Post, May 4, 1923.

as to its adverse economic effects. Mr. John C. MacFarland of Canadian Electric Co., Toronto, contended in his address before the Second Canadian Tax Conference in 1924 that the income tax represented double taxation upon those businesses already subject to sales tax legislation, that it discriminated between types of corporate enterprise, that it lacked provisions for averaging of business losses and profits, and that the administration was very imperfect.[18] But the best arguments against the tax were put forward by Mr. E.B. Ryckman, Conservative member of parliament, during the budget debate of 1923. At that time, the Progressive Party, dissatisfied with the cuts in customs duties, proposed an amendment to the budget in respect to tariff reductions and suggested a readjustment and extension of income tax as to bear more heavily on unearned incomes.[19] Mr. Ryckman adopted the arguments advanced against the income tax by Mr. Otto Kahn, a New York banker, namely, that the tax drives capital out of constructive use, lessens the incentive to venturing, restrains prosperity and expansion and reduces saving, and he added to them its adverse effects upon production and employment. In his belief the income tax was just an "intolerable nuisance".[20]

The income tax would not have suffered much from its

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18. Canadian Tax Conference, Second Annual Convention held under the Auspices of the Citizens' Research Institute of Canada, Montreal, Sept. 10-12, 1924. Minutes of Proceedings.

19. See Mr. Forke's amendment, Debates, 1923, p. 2781.

20. ibid., 1923, p. 2913.

critique. Many defects could be easily corrected or eliminated by more efficient administration and by enactment of similar provisions to those already in force in the United States. But serious danger was coming from the general complaints of heavy taxation and nearly a popular demand for an over-all reduction of taxation. The Progressive Party was demanding reductions in customs duties, and every year gained some relief from the Liberal government dependent upon their support. The other parties again urged cuts in direct taxes, and the Minister of Finance was compelled to give up some ground, too. To be sure, the Progressive members of parliament also spoke in favor of extension of personal exemptions and allowances for dependents,[21] and due to gradual exceptions of incomes of persons in the lower brackets the tax was losing its universal character. In 1926 only 209,500 persons paid income tax as against 290,000 in 1922. The amendments of 1926 exempted another 90,000 taxpayers so that in the subsequent year the number of taxpayers hit its lowest mark, a total of 116,029.

The agitation for lower tax rates, stimulated by two subsequent revisions in the United States, remained until 1926 of no effect. Mr. Joseph E. Howes of Toronto complained at the second Canadian Tax Conference that the high rates deterred the flow of capital into Canada because of lower rates in the

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21. The most outspoken advocate of high personal exemptions was Joseph Archanbault, member for Chambly and Vercheres, Que.

United States, and the Conference went on record in favor of reducing the Canadian rates to the American level.[22] However, the reduction of the tax rates represented a dangerous point in view of the avowed opposition of the Progressive Party, and the Minister's proposal in this direction could easily have meant an end of the government. Only when the Progressive Party was fading away during the short-lived fifteenth parliament, the Minister of Finance decided to introduce a revamped scale of tax rates. In fact, it was done as a gesture to the business strongly lobbying abolition of the tax.

During 1926 an obscure organization styling itself the Retail Trade Bureau of Canada, a dissident group of the larger organization, the Retail Merchants' Association of Canada, was in the van of a vigorous and persistent campaign for the repeal of the income tax, and the bureau had won some influential people in parliament. The editor of The Financial Post, who usually correctly voiced the opinion of business interests in Canada, did not go as far as the Bureau, but reminded the Minister there was a very widely held opinion that nothing would benefit the nation as a whole, more than a big cut in the surtax now charged on large incomes in Canada.[23]

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22. See footnote 18.

23. The Financial Post, March 26, 1926.

When the new rates were announced the Progressive group through their leader, Mr. Forke, expressed definite dissatisfaction. He warned the government that despite the lobbying against the tax carried on in the lobbies of the parliament during the budget debate, he and his followers were firm believers and supporters of the income tax. Their resentment of the budget proposals was indirectly instrumental in ending the Liberal Ministry.

At the time, when the sixteenth parliament assembled the Progressive Party was gone. Some of its members joined the ranks of the Liberals, some were defeated, and only a small group of the representatives of the United Farmers of Alberta, since then known as the Ginger Group, survived, and carried on the doctrinaire part of the Progressives' programme. The 10 per cent cut in the tax rates introduced in 1927 evidenced a new attitude of the government. The tax was seriously challenged by most influential opponents, foreseen by Sir Thomas White, namely, the provincial governments.

Early in November, 1927, the first post-war Dominion-Provincial Conference convened to discuss and to reassess intergovernmental relations in all avenues of their activities. Fiscal matters occupied one of the prominent places on the program of the conference. Since the war the provincial governments were continually called upon to provide new services in the fields for which they were constitutionally responsible. The

governments struggled with serious difficulties in obtaining necessary revenues, for their taxation field was not only restricted by the letter of the B.N.A. Act but also by the extensive direct taxes imposed by the Dominion Government. During the discussion of the fiscal affairs the Province of British Columbia and Manitoba made a strong plea demanding the Dominion Government to vacate the field of income tax in favour of provinces. Oddly enough, the case in this matter was presented by the Premier of Manitoba, Mr. John Bracken,[24] who, in a way, was a product of the western agrarian movement.

The move of the provinces against the income tax stimulated the campaign of its opponents from business ranks in the same direction. The Retail Trade Bureau of Canada intensified its agitation for the abolition of the tax with hearty support of all those who believed that the state could be run with one's neighbor's taxes, and kept on repeating the old objections against the tax. It put forward that the tax forced Canada into competition with other countries where no income tax existed, or where the tax was light; it was only one of nine

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24. Mr. John Bracken, Premier of Manitoba, submitted to the Conference the following five propositions:

1) that the provincial revenues are inelastic;
2) that the entry of the Dominion government into the field of direct taxation increases the difficulty of the provinces;
3) that there is urgent need for more clearly defining the powers of the provinces to impose taxation and the taxes they can impose;
4) that Section 92 of the B.N.A. Act should be amended in order to assign specifically certain taxes either direct or indirect;
5) that the payment of increased subsidies should be provided for, or some percentage of the Dominion receipts from the income tax should be paid over to the provinces.

sources of government tax revenues; it placed a double tax on dividends; it discouraged investment of capital; it penalized personal enterprise; it lent itself to evasion; it taxed profits and allowed nothing for losses; it opened the way for corruption.[25] The propaganda became so intensive that some businessmen felt necessary to counter it. The Montreal Board of Trade in November 1927 unanimously reaffirmed their belief after very careful examination of all methods of taxation that the income tax was socially just and economically sound.[26] The Financial Post ran an editorial in February, 1928, censuring the campaign of the Trade Bureau, and defending the tax. The editor warned that "the campaign for the abolition of the income tax may do more harm than good," and then he continued:

> "The income tax has become part of our tax system during the war and is to that extent a war measure. Some day when Canada has practically recovered from the financial after-effects of the war it may be possible to drop the income tax entirely. But although the war is over, we are still paying for it directly in annual payments of $125,000,000 a year for interest on war debt and pensions, and indirectly in other governmental expenditures. The signing of armistice did not make it possible to end war taxation..." 27

Dismissing the charges of the Retail Trade Bureau with a brief remark that they would apply to any form of taxation,

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25. Cf. The Financial Post, Feb. 10, 1928.

26. Cf. Citizens' Research Institute of Canada, Canadian Tax Conference, 1929, Minutes of Proceedings, p. 47.

27. The Financial Post, February 10, 1928.

and that they affect chiefly the administration, which could and should be improved, the Editor concluded: "The Minister of Finance will not now abolish the income tax, but he will, if business demands it, further reduce it and improve its operation."

The combined pressure of the provinces and some business groups induced the government to put the question squarely before Parliament and the country. Mr. Robb, the Liberal Minister of Finance, delivering his budget message on February 16, 1928, introduced the income tax reductions with the following words:

> "As an added encouragement to business, as a measure of relief to taxpayers, and to those provinces where local income taxes are levied, it is proposed that the Dominion shall continue gradually to lighten the load in the income tax field. Today we are able to go a step further and to propose that the income tax payable by individuals be reduced by an additional ten per cent.... In the case of corporations and joint stock companies it is proposed that the tax be eight per cent." 28

It is rather doubtful, if the government expected the reaction with which the proposal was met in the Parliament as well as in the country. The ensuing budget debate made it abundantly clear that if there were any differences in regard of income tax, they pertained more or less to the details and imperfections of the law, but definitely not to the principle *per se*. It is worthwhile to point out that the Conservative opposition, although censuring the government for a rather light treatment

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28. *Debates, 1928*, p. 511.

of tax evasion always supported frankly the amendments introduced by the minister. Mr. R.C. Matthews, Conservative member of parliament for Toronto East Centre, in a constructive critique of the income tax clarified explicitly the position of his party when stating: "We have not asked for its abolition, but we submit that its application should be fair, effectual, and equitable."[29] What the Conservatives advocated amounted to retaining the tax with lower rates and lower personal exemptions as to eliminate the charge against it being a class levy. In this point they mainly differed from the Progressives and some Liberals.

The government's intent to drop the tax, however, alarmed most the remnants of the Progressive party in Parliament. They spoke at length to the subject during the preceding debate on the Address from the Throne, when they got even with strictures of the Retail Trade Review. But when they heard the passing-bell of the income tax, they rallied to its defence regardless of party lines. Mr. A. Speakman (Prog., Red Deer) delivered an eloquent defence of the income tax on behalf of the "Ginger Group" of the U.F.A., and doing so, he lived up to the tradition of his predecessor, Dr. Michael Clark. After having rejected the invectives of the press and of some members of parliament that they objected to income tax reductions because

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29. ibid., 1928, p. 789. Mr. Bennett (later Viscount) the leader of the Conservative opposition, took strong exception to double taxation of dividends. As a firm proponent of the turnover tax, he considered the income tax to be a colossal failure in Canada. (Cf. ibid., 1928, p. 1250.

they and their constituents did not come within its scope, he went on to speak for the tax on its fiscal merits. He pointed out firstly, that the country had yet to pay for the war expenditure in the form of debt interest, pensions and aftercare of returned men which amounted to a $164 million annual liability. Touching upon the old spirit of National Policy he reminded the government of its duty to carry on the country's development, particularly in the West, which was to be abandoned due to the lack of necessary funds, and charged that it forced the western farmer, afflicted by drought, to contribute their share of carrying on the affairs of the country. "How will they look", he asked, "at this reduction in the tax that brings no hardship to anyone?" And then he addressed himself to the Liberal government benches:

> "Year after year we have heard that the Liberal party is the party of low tariffs, and that one of their missions is to strike from the limbs of this nation the shackles of undue protection and to save us from the commercial interests which might exploit us.... If you eliminate the income tax and reduce the sales tax, you are driven more and more to this position from which you cannot escape - that to carry on the affairs of the country, you must maintain a fairly substantial tariff or customs tax; there is no alternative. What then of policies of the Liberal party? Are they prepared to accept that as the logical outcome of the attitude taken by the party as a whole?.... Yet that is the logical and inevitable result of this reduction and the eventual elimination of any alternative form of taxation." 30

Fr. Fansher (Prog. Lambton) moved a subamendment to the budget, seconded by Mr. Evans, that "the government proposes

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30. <u>ibid.</u>, <u>1928</u>, p. 634 ff.

further reductions in the income tax, thus making a serious departure from the principle of direct taxation; that the proposed revision of customs tariff is inadequate to bring effective relief to the consuming public, and that the sales tax on the necessaries of life has not been eliminated".[31] Like arguments in favor of income tax and against the revocation of it were echoed by Progressive and Labor representatives throughout the debate.

The Liberal-Progressives felt quite uneasy because of the allocutions of their former fellow-in-arms. Mr. J.L. Brown (Lib. Lisgar) frankly admitted that it was a matter of great regret to him when he heard it announced that the income tax was to be reduced. "I have expressed myself", he stated, "on that matter in no uncertain terms in the past, and I have not seen fit to change my mind".[32]

Although we do not intend to survey the kaleidoscope of public opinion which more or less closely reflected the speeches in the House of Commons, we may single out two stands taken by financial journals. The Financial Post supported the government's move to leave the personal income tax to the provinces, but strongly recommended to keep the corporation tax in the Dominion fiscal system. The Financial Times, on the

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31. ibid., 1928, p. 705. Note the different attitude of both progressive speakers toward the sales tax.

32. ibid., 1928, p. 1037.

other hand, stood for a federal income tax as it was, saying that the tax was wholly suitable for Canada, and censured the government's policy of leaving this field to the provinces.

The last words of the debate were those of the Prime Minister himself who was bound to clear up the government's stand on the income tax. After a long review of its fiscal history under his ministry he admitted that the government was inclined to drop the tax on personal income. However, in view of the preceding debate he felt it necessary to assure the house that such a plan had been now entirely abandoned."I may say", he emphasized, "that if we ever entertained an idea of giving up the individual income tax to the provinces or for any other purposes, certainly the discussion that has taken place in the house during this debate will preclude anything of that kind for the future."[33]

Thus, the budget debate of 1928 has definitely solved the place of the income tax in the federal revenue system. Henceforth the attention of the Ministers of Finance has been concentrated on ensuring its effective functioning, which included, among other things, the elimination of duplication of Dominion and provincial or municipal income taxes. This problem played a prominent role in its further development during the thirties, and it has remained open up to the present time.

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33. Ibid., 1928, p. 1281.

The Fiscal and Economic Aspects of the Income Tax During the Twenties.

Despite considerable criticism of its adverse effects upon the nation's economy, the income tax hardly exercised any such influence during the twenties. The short-lived primary postwar depression between 1920 and 1924 was more or less brought about by the dislocation of the world economies consequent upon the war. Albeit it might be argued that the rigid penalties, coupled with an increase of tax rates which were introduced in 1920, accentuated the slump through their influence upon business expectations, the magnitude of this impact seems to have been almost negligible as compared with the external, non-fiscal factors.

After the deliberate introduction of a double levy upon dividends in 1926 the manufacturing interests repeated year after year that the tax discouraged the volume of investment - domestic as well as foreign - in Canada. But a glance at Table J[34] reveals that the amount of dividends paid either to non-residents or to Canadian investors increased considerably between 1926 and 1929. The argument was later dismissed by Mr. Bennett, one of its chief proponents in parliament stating that "in other countries where the argument has been disregarded there has been no such result. People continue to invest where they think it safe and where they can secure under

34. See Statistical Appendix, p. 268.

reasonably sound conditions the largest income."[35]

The fiscal importance of the tax presents a slightly different picture. After the first two rather discouraging results of 1919 and 1920 the combined yield of the personal and corporate income tax was $46 millions in 1921 ($64 millions inclusive business profits tax). In the following year it hit the high mark of $78 millions ($101 millions business profits tax inclusive) which remained unsurpassed until 1937. Despite the liberal exemptions granted year after year during the latter period the tax maintained a relatively stable yield - around 15 per cent of the total tax revenue, sticking closely to an average of $50 millions.[36] In fact, the revenue from income tax which stood in 1927 at the $47 million level was increasing steadily since then until it has reached the present billion dollar average.

It was rather unfortunate that the Liberal government did not seize upon the opportunity after 1925 to consolidate the heavy public debt, when all conditions favored such a move. The economy would easily have sustained considerably higher income taxes, which could have helped to retire the nation's obligations, and a skilful refunding of the rest, advocated by the Conservative opposition, would have prepared the country for the great depression which fell upon the nation

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35. Debates, 1934, p. 4131.

36. See Appendix, Table B.

as soon as the new decade began.

The Income Tax During the Period of 1930-1939.

The time-honoured tradition of bringing down a budget with a wide range of tax cuts was upheld by the Liberal government also in 1930. Mr. Dunning, who assumed the finance portfolio after the death of J.A. Robb, announced in his budget speech a host of exemptions from the income tax designed to ensure the return of the government. Firstly, the allowance for dependents ($500) was granted in respect to all dependent parents, grandparents, brothers, sisters, sons and daughters incapable of self-support on account of mental or physical infirmity, and not otherwise provided for. That put on an equal level all persons supporting close relatives with single persons and widows and widowers maintaining a self-contained domestic establishment.

Secondly, donations to churches, schools or hospitals in Canada operated as such and not for private benefit or gain became tax free up to 10 per cent of a taxpayers' income.

Thirdly, the income of cooperatives was exempted regardless if they were marketing produce of their members or purchasing supplies and equipment for them, provided that the value of merchandise sold to non-members did not exceed 20 per cent of the value of goods sold to members.

Fourthly, the government and other like annuities were

made tax free up to $5,000.

In addition, the amendments included some provisions respecting the corporate tax. The dividends paid to the parent company became tax exempt, provided that the tax was paid by the subsidiary company, and that the subsidiary was not terminating its business. In the case of the winding up of a subsidiary, the undistributed profit on hand was subjected to the tax. Family corporations were permitted to elect within thirty days after incurring tax liability to be taxed either as corporations or as a partnership, but with a proviso that the corporation irrespective of its election became liable to the corporate tax upon the share of its non-resident members. This provision was inserted into the law in order to block tax evasion in cases where one member of the family directed the affairs of the company, and paid taxes on his share, whereas other members could escape the tax by acquiring non-resident status. Similarly, the non-resident directors, officers or employees of a company carrying on business in Canada, who owned or controlled a majority of its voting stock, were liable to tax upon their dividends and interest, as well as upon their salaries. All amendments became effective as of January 1, 1929.[37]

At this time the Minister of Finance cautiously evaded any extensive discussion of the unemployment problem. Prior to

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37. Statutes of Canada, 20-21 Geo. V, c. 24.

his budget message, the Premiers of Manitoba and Alberta made some representations to him demanding the government to vacate the income tax field as to enable the provincial governments to meet the rising costs of unemployment relief, but the federal government could hardly risk a similar move in view of near general elections. Even the moderate increase of tariff rates on steel and iron which was proposed as to protect the iron industry elicited criticism from western progressives. As W. Irwin (Prog., Wetaskiwin) pointed out, judging by the budget proposals the people of Canada were only to decide in the approaching election whether they considered either Mr. King or Mr. Bennett as the better man to carry into effect the same protectionist policy in the Dominion.[38]

Generally, the unemployment problem was belittled in its early stages, and particularly the opposition believed that a good dose of protectionism could solve the crisis. Mr. R.B. Bennett was lavishly giving pledges that, if elected, he would end unemployment and restore business confidence. Since the Liberal party could not advance anything better,[39] the bewildered nation decided to follow the impressive leader

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38. Cf. Debates, 1930, p. 1841.

39. The intent of Mr. Dunning to transfer the income tax field to the provinces, if effected, would have had similar adverse consequences as did the Conservative tariff policy.

of the Conservatives.

Income Tax under the Bennett Regime.

Bennett misjudged the possibilities of protectionism as well as the peculiarities of Canadian economy and its instruments. Protectionism, if applied to a young economy during the upswing, may stimulate establishment of new industries and strengthen those already established. But during the downswing its effects upon the distribution of national income cannot be outweighed by the size of employment it ensures in sheltered industries. This was the case in Canada during the depression. The secondary industries of Central Canada shifted the burden of the depression to the primary industries, mainly agriculture, wood and pulp, and fishing, located in the West or in the Maritimes, which suffered most. Due to their key position in the economy, they carried with them the creditors, and the rest of the edonomy as well, into the depths of depression.

During the crisis the federal government was faced with a twofold problem. On the one hand there was the necessity of countering the downswing in general, and on the other hand there was the secondary problem of distributing the load of depression more equitably among the various sectors of the economy. Both of them required bold economic and fiscal policies, which the rank and file as well as the government of the Conservative party were considering as too risky. They preferred

to stick to the orthodox line of balanced budgets, low government expenditures, and a "sound" money policy.[40] These principles were adhered to even after the rest of the world departed from them, and only in 1935, when there were already signs of an upswing, the Prime Minister surprisingly reverted to the "Roosevelt line".

It must be admitted that the Dominion government was handicapped in meeting the crisis. The question of constitutional responsibilities for unemployment relief rested with the provincial governments. The absence of an effective central banking system discouraged adoption of inflationary measures out of fear that they could become uncontrollable. The tax system had been impaired by the previous administration by shifting the emphasis to indirect taxation. In removing these defects the Bennett ministry were successful and strengthened the economic and political instruments of the Dominion. The Statute of Westminster, the establishment of a central bank, and strengthening of the position of the income tax in the federal revenue structure represent positive achievements of Bennett's era.

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40. The Financial Post, was very critical of the views of J.M. Keynes. For example, in the issue of April 2, 1931, it referred to him as follows: "John Maynard Keynes, the British economist, has succeeded in maintaining himself in the spotlight ever since the end of the war. On some occasions he has done it by imaginative thinking lacking in soundness. Now he has given the public something to talk about in his statement that when a man saves five shillings he robs another man of a day's work.

Mr. Bennett, who assumed the portfolio of finance in addition to his duties as Prime Minister, soon found out that the high tariff policy neither solved the economic difficulties nor ensured the inflow of revenue to the treasury. In his budget message of 1931 he was compelled to revert to the inland revenue sources, and particularly to the income tax. To fulfill his ambition of giving Canada a modern fiscal system he introduced a redrafted income tax bill elaborated by the Commissioner of Taxation and his staff which, as its name indicated, were to become a permanent part of the federal fiscal system. The resolutions increased the tax rates. The corporation rate went up to 10 per cent, and the personal rates were graduated from 1 per cent on the first $1,000 of taxable income up to 25 per cent on incomes in excess of $25,000. The bill contained some improvements, especially in taxation of corporate incomes. However, the bill was withdrawn later on, and only the increase in corporation tax rate was put into force.

The opposition parties bitterly attacked the budget, and, as the debate proceeded, the strictures were assuming a form of personal invective. The seemingly low rate on higher income brackets was the centre of interest. Mr. King compared the principle with feudalism when the seigneurs were exempted from all public tributes save the feudal aids, and Fernand Rinfret (Lib. St. James) accused the Prime Minister of endeavoring to

detax his fortune.[41] W.R. Motherwell, the former Minister of Agriculture in King's ministry, fingered to the government benches: "Here we have the government which admittedly includes at least four millionaires, possibly multimillionaires, sitting around the council tables and trying their best to withhold millions from the treasury by lowering the income tax on multimillionaires."[42]

The result was that when the bill came into the Committee for the first reading Mr. Bennett, deeply hurt by the invectives, withdrew the resolutions save the increase of corporation tax rate.

Under the impact of depression the government revenues suffered considerably, and the percentage ratio was shifted to internal taxes. In 1934 the revenue from customs duties approached the lowest point since 1910, netting $66 millions, only five millions more than the sales tax or the income tax. Both internal taxes were altered frequently during the depression which prevented their yield from falling. Mr. Rhodes, who relieved the Prime Minister in the portfolio of finance in 1932, introduced many amendments during his tenure of office which affected all important factors of the income tax. The

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41. " The Prime Minister promises anything; he promised moonbeams and prosperity for this country, so I say if instead of doing that he had told the people...."In my first budget to the house I shall tax fuel, I shall tax tea, I shall tax oranges, I shall raise the sales tax, I shall put a tax on small cheques, ... and when I have done all that and have received from the humble people of the country more money than I need I shall detax myself by 25 per cent of my income." Debates, 1931, p.2278 ff.)

42. Debates, 1931, p. 2622.

following is a summary of his alterations.

In 1932, the personal exemptions were lowered to $2,400 and $1,200 for married and single persons respectively, and the allowance for annuity income was cut from $5,000 to $1,200. In the case of personal incomes, the deduction of 20 per cent from the tax granted in 1927 and 1928 was repealed and an additional surtax was imposed on net incomes in excess over $5,000. The corporation tax rate was increased to 11 per cent. These amendments were applicable to 1931 incomes.

The resolutions announced in the budget speech in the following year (1933) broadened the tax further. Personal exemptions were reduced to $2,000 for married persons or those with equivalent status, and to $1,000 for single persons. The basic exemption of $2,000, hitherto allowed to corporations, was repealed. The dependent's allowance was reduced to $400. The first schedule of the income tax was substituted by a new one which increased the rates on personal incomes throughout. The graduated rates started with 3 per cent on the first $1,000 of taxable income and progressed upward by one per cent for each income bracket ($1,000 up to $20,000, then $5,000 up to $100,000, then $10,000 up to $175,000, then $25,000 up to $400,000, the highest bracket being $25,000 going up to $500,000), until it reached the upper limit of $500,000 with a tax rate of 56 per cent on incomes in excess of that amount. The surtax of 5 per cent on incomes over $5,000 was continued. Corporations

and joint stock companies were allowed, for the first time, to file consolidated returns. Consequently two rates were introduced, 12 1/2 per cent for companies filing ordinary returns and 13 1/2 per cent for consolidated returns. In addition to these changes in tax rates the amending law of 1933 imposed a special tax (withholding tax) of 5 per cent in respect of all dividends, interest and royalties received by non-residents from Canadian debtors, and the same rate was levied in respect of interest and dividends, paid by Canadian debtors to Canadian creditors in currency which was at a premium in terms of Canadian funds. All provisions were applicable to 1932 income save the withholding tax which came into force on April 1, 1933.

No changes were effected in the schedules of tax rates in 1934, but the budget speech forecast some minor alterations designed to remove the inequalities in the operation of the tax. Most of the amendments introduced later during the session dealt with the tax liability of non-residents. The law affected interest paid to non-resident parent companies, exemption of dividends received by similar company, advances to non-resident corporations, the taxation of personal corporations in respect of non-resident interest, non-resident beneficiaries, and it redefined the term of "carrying on business in Canada" by non-residents. The law also made taxable periodical receipts like rents, royalties and annuities. It allowed deduction of interest on succession duties, and more specifically regulated

the computation of income from estates and trusts. Sections 17 (redemption of shares at premium) and 19 (distribution of winding-up or reorganization) of the Act were streamlined more. And to conclude, the 5 per cent tax on interest and dividends payable between Canadian debtors and creditors in currency at a premium in terms of the Canadian dollar was retained for another year.[43]

The success of Roosevelt's administration in the United States stirred the imagination of Mr. Bennett who early in 1935 announced a "New Deal Programme" for Canada in his radio speeches. It covered such wide fields of Canadian life as social security, reorganization of Cabinet portfolios, reforms of the Criminal Code, revision of the customs act and income tax, so that it looked as if a social revolution for Canada were in the making. Some of the proposed reforms he was able to put through the parliament before the election, but most of them have remained just a guidebook for the subsequent Liberal ministries. "His" Minister of Finance, Mr. Rhodes introduced in the budget speech of 1935 two significant innovations in respect to the income tax. Firstly, the principle of differentiation between earned and unearned incomes was adopted, and secondly, an entirely new tax - the gift tax - was imposed for the first time.

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43. Cf. Statutes of Canada, 22-23 Geo. V, c. 43 (1922); 23-24 Geo. V, c. 41 (1933); and 24-25 Geo. V, c. 55 (1934).

Introducing these amendments Mr. Rhodes dutifully referred to the broadcast of the Prime Minister of January 2, 1935:

> "In an address delivered a few weeks ago the Prime Minister made certain references to the necessity of changes in our income tax structure. It was pointed out at that time that incomes may be regarded generally as falling into two categories, which may be described broadly as earned income and investment income, and that this distinction which is recognized in the tax systems of other countries might fairly be held in mind when the question of distributing the burden incidental to providing increased social security was being considered."

Passing to gift tax he stated:

> "It is particularly expedient to introduce this measure at this time in view of the higher rates of taxation provided for in the new surtax on investment income. Not only should this tax put our tax structure on a more secure foundation but also it should operate in a like manner with respect to succession and inheritance taxes levied by the provinces."

In defining the earned and unearned income the Minister of Finance took a very conservative estimate as to what comprised either of them. According to the amending law of 1935 (25-26 Geo. V, c. 40) the definition of earned income ran as follows:

> "Earned income means salary, wages, fees, bonuses, pensions, superannuation allowances, retiring allowances, gratuities, honoraria, and the income from any office or employment of profit held by any person, and any income derived by a person in the carrying on or exercise by such person of a trade, vocation or calling, either alone or, in the case of partnership, as a partner actively engaged in the conduct of the business thereof, and includes indemnities or other remuneration paid to members of Dominion, Provincial or territorial legislative bodies or municipal councils, but shall not include income derived by way of royalties, or any income, irrespective of the source or combination of sources from which it may be derived, in excess of fourteen thousand dollars." (Section 2, paragraph m).

As may be readily seen, the definition comprised two limits,

firstly, a limit as to the source of income, and secondly, a limit as to its amount. Income not falling within those two limits was, by definition, investment income.

In computing his investment income tax liability, the taxpayer was allowed a basic exemption whichever was the most favorable from the three following exemptions: either $5,000 of investment income, or $14,000 of earned income, or an amount of income equal to the sum of the personal exemption and allowances for dependents to which he was entitled under the provisions of the Act. For example, if the total of personal exemptions exceeded the exemption granted in respect of investment income he could claim the former one.

Due to these new differentiations of taxable income the taxpayers in the higher brackets paid a triple tax: a normal tax graduated according to Schedule "A", and additional 5 per cent rate on incomes over $5,000, (Schedule"B"), and a surtax on investment incomes computed in accordance with the following table:[44]

"On investment income included in any income exceeding $5,000 but not exceeding $10,000.................. 2%,

investment
On income included in any income exceeding $10,000 but not exceeding $14,000......................... 3%,

or

on income over	$14,000	but not over	$20,000	3%
	20,000		30,000	4%
	30,000		50,000	5%
	50,000		75,000	6%
	75,000		100,000	7%
	100,000		150,000	8%
	150,000		200,000	9%
on income over	200,000			10%

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44. 25-26 Geo. V, c. 40.

It must be noted, however, that the additional 5 per cent tax applied to both the general tax and the surtax as well.[45]

The gift tax provisions (section 88) charged with a tax liability any individual residing or ordinarily resident in Canada in respect of any property (whether situated within or outside of Canada) transferred directly or indirectly, in trust or otherwise by way of gift or donation. The following transfers were exempted: any gift not exceeding $4,000; transfers by devise, bequest or by intestacy; gifts to charitable or educational institutions or to the Dominion of Canada, its provinces or other political subdivisions; and some inter-family transfers. The tax was payable at the time when the transfer was effected, and both the donor and donee were jointly liable thereof.

The schedule of tax rates imposed a 2 per cent rate on gifts over $4,000 up to $20,000 and then it progressed by one per cent up to 10 per cent, which rate was chargeable on gifts over $1,000,000.

Corporations were excluded from the tax liability on

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45. The computation of total tax liability of a married person with no dependents, receiving an income of $20,000, all earned, was as follows:

General tax on $18,000	$2,070.00	
5% additional tax	103.50	$2,173.50
Surtax:		
Exempt $14,000		
$14,000 to $20,000 at 3%	180.00	
5% additional	9.00	189.00
Total tax payable		$2,362.50

investment income, but the tax rates applicable to their incomes were further increased to 13 per cent and 15 per cent in cases of normal and consolidated returns respectively.

Dunning's Amendments of the Income Tax.

The general election of 1935 returned the former Liberal Minister of Finance not only to parliament, but also to his Cabinet post. During his absence the tax underwent a marked metamorphosis, and its revenue function was fully recognized. Since the scope of the tax was materially broadened, the incidence improved and the rates increased, Mr. Dunning confined his attention more or less to the refinement of the law particularly in the sphere of corporate income taxation, and to its administration. Increased taxation of non-residents' income may be singled out as a specific feature of Mr. Dunning's legislation.

Prior to the 1935 taxation year, investment corporations were taxed under the provisions applicable to all companies. But in 1936, the Minister of Finance following the example of the U.S. legislation of 1934, introduced a measure which singled out non-resident-owned investment corporations (n.r.o. companies) for a special treatment. The n.r.o. corporation had to fulfil certain requirements in order to qualify for separate taxation. It had to be incorporated in Canada; secondly, 95 per cent of its assets (issued shares, debentures, securities or evidences of funded indebtedness) had to be owned by non-residents of Canada, or held by trustees for their own benefit

or for that of their unborn issue; and thirdly, its gross revenue was to be derived either from ownership or dealing in bonds, shares and similar securities, or from lending money, or from any right, title or interest in or to any estate or trust. Such a corporation was allowed to elect, either to be taxed as an ordinary corporation or at one-half the rate of the normal corporate tax rate subject to certain restrictive provisions which pertained to computation of income and deductions. In the subsequent year the companies dealing in small loans (up to $500) were excluded from the privilege granted to n.r.o. companies.

Since the 1935 taxation year the exemption afforded to Canadian companies with assets wholly situated outside of Canada was restricted to investment companies whose shares had been offered for public subscription or were listed on a recognized stock exchange, and companies whose business operations are of an industrial, mining, commercial, public utility or public service nature. However, their obligation to file annual returns and to pay an annual filing fee was preserved.

Other important amendments exempted the income of metalliferous mines coming into production between May 1, 1936 and January 1, 1940 in its entirety from the corporate income tax.

The amending law of 1936 inserted into the Act new provisions in respect of payment of tax and interest thereon, payment of gift tax, and empowered the Governor-in-Council to make arrangements with provincial grants for collecting the provincial

income taxes by the Department of National Revenue. The corporate tax rate was increased to 15 per cent and 17 per cent on 1935 incomes for normal and consolidated returns.

In 1937 no significant amendments were effected, save the provision interpreting the tax liability incurred under the old Business Profits tax Act, 1916.

The provisions adopted in 1938 (Chapter 48) exempted from the corporate income tax the dividends received by Canadian corporations from their subsidiaries located abroad. They allowed as a deduction a lump sum payment made for the establishment of employees' superannuation or pension fund; and the same treatment was accorded to royalties paid abroad which originated in Canada. The regulations against tax avoidance either by way of arrangements with non-residents or upon distribution of company's assets were stiffened. Due to a restrictive interpretation of the meaning of annuity income by the courts, the law was amended to make taxable all annuities derived by beneficiaries from estates irrespective whether or not they contained a part of the property of the estate.

As to the gift tax , the amending statute of 1938 increased the gift tax rates ranging from 5 per cent to 15 per cent on the same brackets as before, and limited the amount exempted from the tax to one-half of a taxpayers income less income tax otherwise payable thereon.

Amendments of 1939.

Mr. Dunning kept his assurance given to mining interests in 1936, and, as his last budget indicated, the Liberal government pursued steadily the policy of furthering the industrialization of the country. An outstanding feature of the 1939 budget was a capital allowance granted to all industries, whereby a taxpayer was permitted to deduct from his tax an amount of 10 per cent of all his capital costs expended within the following year on construction, installation, manufacture, betterment, replacement or extension of buildings, machinery or equipment, provided the assets were to be used in earning income of the taxpayer. However, the allowance was limited only to those improvements of earning assets which were located in Canada, and it did not include excessive costs. The deduction was chargeable against the taxes payable within three subsequent taxation years.

Alluding to this measure the minister expressed a belief that it would promote employment in the construction, machinery and equipment industries, and that it should help to place all industries on the modern and up-to-date basis, and thus to enable them to cut the costs and to compete more effectively on both domestic and world markets.[46]

The three-year exemption of income of new metalliferous mines was extended as to apply to all such mines which would

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46. Cf. Debates, 1939, p. 3151.

come into operation during another three year period ending January 1, 1943.

Furthermore the amending statute exempted dividends of companies which did not pay corporate tax on account of allowances granted to metalliferous mines or capital cost deduction. The less important amendments dealt with tax evasion and avoidance, rental payments on motion picture films, salaries paid abroad, and adapted the definition of "taxpayer" to that of "person".

During the second session of parliament in 1939 there were further alterations introduced under the impact of war, which will be discussed in the following chapter.

The Income Tax in a Depressed Economy.

The Great Depression refuted at one stroke both Canadian classic doctrines of fiscal policy, viz., the Conservative "tariff for protection" and the Liberal "tariff for revenue only". Bennett's tariff of 1930, which would have pleased the staunch protectionists at the outset of this century, neither protected the Canadian economy against the crisis nor assured sufficient revenue to the treasury. The crisis slipped in through the unprotected channel of export trade, and the customs revenue kept falling despite the many increases of tariff rates. The old quandary of opposite trends in expenditure and revenue became once again actual, and the same party was called on to its solution. During the first World War it tried borrowing, and was criticized and thrown out of power, so under Bennett's

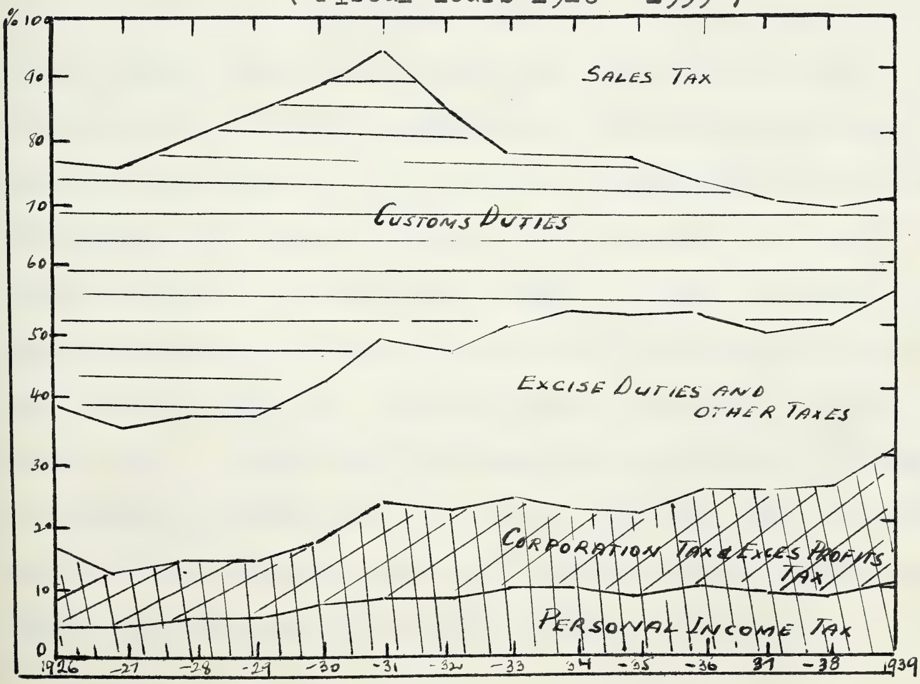
leadership it tried taxation with a similar aftermath. Twenty years have almost passed away since then, and the party has not been able to cross the floor of the House of Commons.

The failure of tariff as a revenue producer induced Mr. Bennett to employ both major inland taxes, the sales tax and the income tax. But as Chart II shows, the Conservative Government relied more on the sales tax than on the income tax in its revenue policy. The combined effects of the weakening yield of customs duties and total tax revenue in absolute terms together with sharp increases in sales tax rates (from 1 per cent in 1930 to 4 per cent in the subsequent year and

Chart II.

Percentage Distribution of Total Tax Revenue
Among Various Tax Sources.

(Fiscal Years 1926 - 1939)



Source: The Canada Year Book .

further to 6 per cent in 1932) were chiefly responsible for the steep enlargement of the sales tax share in the federal tax revenue. In fact, this tax made up the proportional loss of customs duties, and prevented any significant shifting of the proportion from consumption taxes to direct taxes.

In absolute terms the volume of federal tax as well as of total revenue suffered materially despite feverish upward revisions of all tax rates. It followed inevitably the sliding course of business activity, and at its deepest point in 1933, the amount of total revenue fell to the lowest mark of the whole inter-war period, providing only $311.7 millions. The current account had to be balanced by borrowed money. Small wonder, that the Conservative financiers demanded that the government cut its expenditures (specifically the transfer payments) in order to balance the budget, perhaps not realizing that a balanced budget might be a result of, but definitely not a cause, of favourable economic conditions. When the necessity of federal assistance to the provinces became more pressing the government was bound to revert to borrowing on a larger scale. Indeed, despite the increase of $1.1 billion in gross Dominion debt during the thirties it involved but a negligible rise of the interest charges. The per capita ratio of interest charges were lower in 1939 ($11.31) than in 1931 ($11.91) because of a successive conversion of existing debt to lower interest rates. Most of the borrowed funds went into financing unemployment relief and subsidizing crippled national railways.

Turning now to the specific problem of incidence of the income tax upon the crisis - stricken Canadian economy, it may be pointed out first of all that the hasty recourse of provincial governments to this source of revenue restrained the federal authorities from pursuing a more vigorous income tax policy. Nonetheless, the government did not hesitate to tap the sources hitherto considered as untouchable, like the income flowing abroad in the form of dividends and interest payments. The withholding tax, the gift tax and finally the discrimination against investment income stand as outstanding features of income tax development during the thirties. Here, although being entirely in accord with the general criticism of the ill-devised taxation policy of the federal government during the depression, we do not subscribe to the idea that during the slump the tax on capital income is more harmful than a tax on labor incomes, if levied on net income accretion.

As may be recalled, the rate schedule applicable to personal incomes was in 1932 restored to its original level and then submitted with a slightly increased one. As Table IV shows, the real effective progressivity was very mild in all income brackets, despite the fact that it was well-nigh doubled for incomes between $4,000 and $100,000. Even the discrimination against investment incomes - more precisely higher incomes- applicable to 1934 incomes did not increase the progressivity to desirable dimensions. The higher rates on investment income entailed the following increment of the total tax liability on incomes over $5,000 shown in Table IV:

TABLE IV. PERSONAL INCOME TAX AT VARIOUS INCOME LEVELS IN SELECTED YEARS.

Income before Exemptions	1917		1919		1925		1927		1932	
	$	%	$	%	$	%	$	%	$	%
PERSONS WITH "SINGLE" STATUS; NO DEPENDENTS										
$1,500	-	-	20	1.3	-	-	-	-	$15	1.0
2,000	20	1.0	40	2.0	10	0.5	8	0.4	30	1.5
3,000	60	2.0	80	2.7	30	1.0	24	0.8	70	2.3
4,000	100	2.5	120	3.0	55	1.4	44	1.1	120	3.0
5,000	140	2.8	160	3.2	90	1.8	72	1.4	180	3.6
8,000	300	3.7	410	5.1	255	3.2	204	2.6	441	5.5
15,000	870	5.8	1,270	8.5	990	6.6	792	5.3	1,396	9.3
50,000	5,320	10.6	9,230	18.5	8,770	17.6	7,016	14.0	10,363	20.7
100,000	14,820	14.8	31,230	31.2	24,370	24.4	19,496	19.5	27,846	27.8
200,000	43,820	21.9	93,230	46.6	65,015	32.5	52,012	26.0	72,660	36.3
PERSONS WITH "MARRIED" STATUS; NO DEPENDENTS										
$1,500	-	-	-	-	-	-	-	-	-	-
2,000	-	-	-	-	-	-	-	-	-	-
3,000	-	-	40	1.3	-	-	-	-	30	1.0
4,000	40	1.0	80	2.0	20	0.5	16	0.4	70	1.7
5,000	80	1.6	120	2.4	40	0.8	32	0.6	120	2.4
8,000	240	3.0	370	4.6	160	2.0	128	1.6	347	4.3
15,000	810	5.4	1,230	8.2	790	5.3	632	4.2	1,228	8.2
50,000	5,260	10.5	9,190	18.4	8,380	16.8	6,704	13.4	10,069	20.1
100,000	14,760	14.7	31,190	31.2	23,830	23.8	19,064	19.1	27,447	27.4
200,000	43,760	21.9	93,190	46.6	64,370	32.2	51,496	25.7	72,187	36.1

Source: Dominion-Provincial Conference on Reconstruction, Reference Book, Personal Income Taxes.

Income	Tax before discrimination	Tax Increase	% increase
$	$	$	
8,000	409	63	0.8
15,000	1,491	263	1.6
50,000	11,959	1,890	3.7
100,000	32,749	5,302	5.3
200,000	86,451	14,227	7.1

When compared with the rise in corporate tax rates, which were doubled (8 per cent in 1929, 15 per cent and 17 per cent for consolidated returns in 1935) during the crisis, the personal rates limped far behind. Consequently, the percentage ratio between the respective yields from personal and corporate tax shows a marked prevalence of the latter. Table V reveals

Table V. -

Relationship Between Personal Income Tax, Corporation Income Tax and Total Income Tax: Income Tax Per Tax Payer.
(fiscal years 1929 - 1939)

Year ended March 31	Income Tax			Ratio (3) to (2)	Ratio (4) to (2)	Number of Taxpayers	Ratio (7) to (3) per Taxpayer
	Total	Personal	Corporate				
1	2	3	4	5	6	7	8
	$000,000	$000,000		%	%		
1929	59.9	24.8	35.1	41.4	58.6	129,633	191
1930	69.2	27.2	42.0	39.3	60.7	142,154	190
1931	71.1	26.7	44.4	37.6	62.4	143,601	185
1932	61.3	24.8	36.5	40.5	59.5	133,621	184
1933	62.2	26.1	36.1	42.0	58.0	166,972	155
1934	61.4	34.0#	27.4	55.4	44.6	203,954	143*
1935	66.8	31.0#	35.8	46.4	53.6	184,195	137*
1936	82.7	40.2#	42.5	48.6	51.4	199,102	166*
1937	102.4	44.4#	58.0	43.4	56.6	217,049	163*
1938	120.4	50.6#	69.8	42.0	58.0	237,064	171*
1939	142.0	56.8#	85.2	40.0	60.0	264,804	176*

* Non-Resident tax excluded.
\# Inclusive Non-Resident tax.

that the share of personal income tax had been continuously below that of corporate tax by 10 to 20 percentage points, and only in the 1933-34 taxation year it netted more in both absolute and relative terms. The same applies to the place of income tax in total tax revenues collected during the thirties where the proportion of corporation tax was steadily enlarging.

The incidence of the personal income tax upon various occupational groups is illustrated by Table VI. The agrarian class, although the largest in Canada, practically disappeared as an income-tax paying group during the depression. Only 262 farmers paid income tax amounting to $22,083 in 1934, or in other words one of every 900 taxpayers was a farmer. The load of the tax rested on the shoulders of salaried employees, particularly those employed by financial institutions who were least affected by the depression. From the business sector the manufacturers represented a very small group as to the number of taxpayers and the tax paid as well, and together with retailers and wholesalers comprised a highly fluctuating source of income tax revenue.

The effects of lower personal exemptions are exposed by the rapid expansion of the number of employees falling within the scope of the tax. In 1930 only 104,000 employees paid the tax, whereas in 1939 over 200,000 of them filled income tax returns.

The withholding tax on non-residents which became effective on 1933 incomes contributed $4.8 million to the government coffers for that year, and its yield rose steadily from year to year.

TABLE VI. INCOME TAX COLLECTIONS ACCORDING TO OCCUPATIONS FOR SELECTED YEARS

Occupational Group	1929-1930		1933-1934		1935-1936		1938-1939	
	No. of Tax-payers	Amount Paid $	No. of Tax-payers	Amount Paid $	No. of Tax-payers	Amount Paid $	No. of Taxpayer	Amount Paid $
Agrarians	2,626	123,909	262	22,083	694	46,609	1,309	124,836
Professionals	7,439	1,716,675	5,941	2,008,471	6,579	1,967,035	7,818	2,621,362
Employees	95,328	8,336,416	167,737	11,340,010	159,972	12,474,844	215,357	16,402,376
Merchants- Retail	9,229	1,248,277	4,960	527,693	6,417	748,782	9,054	1,245,580
Merchants-Wholesale	1,500	464,726	575	217,233	832	318,988	1,041	473,939
Manufacturers	1,001	263,526	467	129,978	547	164,014	787	319,251
Natural Resources	243	79,677	77	11,514	155	41,559	236	75,843
Financial	9,543	7,084,327	11,753	7,512,473	12,995	8,931,621	15,796	15,903,455
Personal Corp.	912	3,614,204	618	2,768,992	538	4,433,134	649	4,771,037
Family Corp.	3,129	1,801,138	1,576	1,354,613	14	31,247	-	-
Corporate Businesses	7,957	41,783,224	8,913	27,988,626	10,970	42,518,971	13,809	85,185,888

Source: D.B.S., Income Tax- Collection Statistics.

Due to the large proportion of foreign capital in Canadian investment (40 per cent during the thirties) this tax was fully justified. Hitherto a considerable part of Canadian national income was flowing abroad without much contributing to the government expenditures. The Financial Post estimated in 1931, when the levy was for the first time proposed, that only 20 per cent of the $335,000,000 of ordinary stock of Canadian Pacific Railway was held in Canada, the majority of the stock of International Nickel Co. was held in the United States and Great Britain, and $18 million of shares of Imperial Oil Ltd. was in the hands of Standard Oil of New Jersey, to mention just a few examples. As the editor figured it out, Imperial Oil, paying a 50 per cent dividend on its shares, advanced every year $9.4 millions to its parent company, which amount was let out tax free prior to the imposition of the withholding tax.

In fact, the 5 per cent tax was exceedingly low, and definitely did not curtail the inflow of foreign capital into Canada. Besides that, the foreign investor, usually a resident of Great Britain or of the United States, could claim tax credit from his government on account of taxes paid in Canada. In this connection it may be noted that the tax treaty with the United States government, ratified in 1937, greatly eliminated duplicate taxation on incomes earned under their jurisdiction.

The incidence of the income tax upon corporate taxpayers varied. Companies whose production was chiefly oriented to foreign markets or producing investment goods, like the pulp

and wood industry, construction, tool and machinery industry, suffered heavy losses which in turn eliminated them from tax liability. Secondary industry, manufacturing for domestic production, which in addition to its natural protection was shielded by high tariffs, bore the burden of income tax, and contributed by far the greatest part of the yield.

The number of companies subject to income tax during the depression is somewhat misleading since the repeal of the basic $2,000 exemption in 1933 boosted considerably the number of corporate taxpayers by adding many small concerns with incomes below that ceiling. For example, in the taxation year 1935-6, from 10,970 corporate returns 6,306 were filed by corporations earning less than $2,000, and the tax assessed amounted only to $547,271, whereas 773 corporations with income over $50,000 paid $36,169,233 out of total $42.5 millions of corporation tax collections.[47]

Despite the fact that the chief cause of the depression was the breaking down of the international credit system, Canadian financial corporations, banks, and insurance companies weathered the crisis with comparatively small losses, maintaining their tax contributions on a fairly constant level.

The gift tax adopted as an ancillary income tax measure in 1935 did not possess any significant revenue productivity. It netted $194,845 in that taxation year, and the total

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47. Cf. Department of Trade and Commerce, D.B.S., Income Assessed for Income War Tax Act, 1936.

Table V11.

Total Income Assessed and Income Tax Yield
as Percentages of National Income
(1929 - 1938)

Year (Taxation)	Income Assessed as % of N.I.	Income Tax Yield as % of N.I.	Pers. Income Tax as % of Pers. Disp. Income
1929	27.6	1.5	0.60
1930	29.6	1.6	0.61
1931	29.8	1.7	0.67
1932	35.8	2.1	0.86
1933	33.8	2.5	1.02
1934	32.0	2.3	0.80
1935	33.6	2.6	0.99
1936	30.9	2.6	1.00
1937	26.2	2.9	1.00
1938	28.0	3.5	1.10

Source: The Canada Year Book, B.B.S., National Accounts, Income and Expenditure, 1926 - 50.

Collections for the three pre-war years amounted to slightly more than one-half of a million dollars.

As may be seen from Table V11 the income tax brought within its scope less than one-third of the national income throughout the thirties, save the year of 1932. Apart from tax evasion and tax avoidance, it reveals that the national income was mostly distributed among income receivers below the personal exemptions which would have justified radical downward revision of all statutory exemptions. As a consequence, the total income tax took but a small slice from the national income. The same may be said of the personal income tax in respect of personal disposable income. The failure of the government to induce any material income redistribution left the community entirely at the mercy of the crisis, and by imposing regressive

consumption taxes even worsened the lot of the unemployed, farmers and their creditors. A well-balanced account of economic consequences of goverment fiscal policies during the depression is, of course, given in the Rowell-Sirois Report, which is a reliable guide for a traveller on the avenues of Canadian economic and social history.

<u>The Constitutional Aspects of Income Taxation</u>.

Following the course of federal income taxation during the inter-war period only a scanty reference was made to its constitutional aspects which, as the years progressed, were becoming more acute. For, since the World War I, the field of direct taxation has been shared by both the Dominion and the provincial goverments which enjoy considerable jurisdictional independence in fiscal matters under the B.N.A. Act. The great social and economic metamorphosis of the Canadian community incident upon the first world war entailed considerable increase of provincial expenditures and compelled the provincial treasurers to look for augmentation of underdeveloped provincial revenue sources. The field of income taxation offered itself to their attention as soon as the financial difficulties had arisen.

During the twenties Manitoba joined the provinces imposing a provincial income tax (British Columbia and Prince Edward Island) partly under the pressure of fiscal difficulties and partly because of demands of its electorate. When the

question of limping provincial finances was on the agenda at the Dominion-Provincial conference in 1927 the Premiers of British Columbia and Manitoba demanded in all earnestness the Dominion government to reconsider its entry into the direct taxation field. Mr. Bracken, Manitoba Premier, did not go as far as Mr. MacLean, the premier of British Columbia who demanded a complete withdrawal of the Dominion from income tax field, but suggested that in lieu of increased federal subsidies the provinces should receive either some percentage of the Dominion receipts from the income tax or should be allowed to levy "supplements" to the federal tax, and in that case the Dominion government should fully cooperate with the Provinces to the end that there might be a saving in the expense occasioned by the duplication of services for collection.[48]

The Conference did not arrive at any definite conclusion, and the problem was left for further consideration. The King government was ready to quit the income tax field toward the end of the twenties, when the secondary postwar boom flooded the treasury with revenue from customs duties and excises, but the proposition encountered considerable opposition in Parliament and in the country as well.

In the meantime the crisis developed, and the idea of exclusive provincial income taxation would have done more harm than good due to the uneven impact of the depression upon the

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48. Cf. The Canadian Annual Review, 1927-28, p. 33.

regional economies. The simple fact that the federal government had to advance much greater amounts to the Prairie Provinces to alleviate their fiscal difficulties than it collected from their residents in the form of income tax payments suffices to prove the dubious value of exclusive provincial income taxation.

However, the depression played havoc with both Dominion and provincial revenues, and fully exposed the defects and the inadequacy of the whole Canadian financial system. If there was a need for an overhaul during the twenties, after the depression it became imperative. In 1932, Alberta and Saskatchewan began levying a tax upon incomes, being followed a few years later by Ontario and other Provinces. Not only this scramble for revenue failed to secure any substantial revenue to the respective governments, but also effected complete chaos in the income tax field, putting an undue burden of compliance on all taxpayers obliged to pay a triple income tax in some provinces.

This deplorable state of affairs as well as the adverse effects upon the economy, were recognized by the federal government which in 1937 appointed a Royal Commission to survey the whole problem of allocation of constitutional responsibilities and tax powers, and to propose solutions.

The Report of the Rowell-Sirois Commission, which represents a cooperative work of seasoned Canadian experts reaffirmed the basic idea of federation of its originators against the Haldane concept. As to the public finance, it went somewhat further. It recommended another restriction of provincial authority to

impose direct taxes to those incorporated into the B.N.A. Act. Let the Commission itself speak:

> "... the Commission recommends that the provinces should withdraw entirely from the following tax fields:
>
> (a) Income taxes (with an exception for premiums for social insurance within provincial jurisdiction);
> (b) Corporation taxes as defined in detail above;
> (c) Inheritance (or Succession Duty) taxes....
>
> The Commission's recommendations in these respects are based on two grounds. (1) The withdrawal of the provinces from these fields is an essential feature of its Financial Plan.... (2) The transfer of these tax sources to the Dominion and their use by one single jurisdiction is essential, both for reasons of equity as between provinces, and for assuring that these tax fields will be exploited with least harm to the national income." 49

To argue the desirability of this recommendation would amount to carrying owls to Athens, for both sides of the point were extensively exploited. Furthermore, subsequent war finance documented abundantly the advantages of a streamlined fiscal system. However, in a democratic society, where the opinion of the least is to be weighed, great reforms proceed sometimes at a slow pace. This has been the fate of the propositions of the Report of the Royal Commission on Dominion-Provincial Relations. Although most of the provinces accepted the partial solution of Tax Rental Agreements, only recently the Province of Ontario joined the "new financial federation" with the Province of Quebec still to come.

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49. Royal Commission on Dominion-Provincial Relations, Report, Book II, p. 121.

The C.C.F. and the Income Tax.

This study would be incomplete without at least a short note on one undercurrent of Canadian political life. We have traced the fight of farmers for an income tax up to the end of the twenties. It is necessary to round out this picture.

The doctrinaire remnants of the Progressive Party, the U.F.A. representatives in the House of Commons found in 1932 a common platform with Labor members, and established a new political party, the Cooperative Commonwealth Federation, a medley of various dissident farm and labor groups, which in time evolved into a definite socialist party. In the following year in Regina, Sask., the convention of the C.C.F. party published a manifesto which formulated its views on all subjects of the nation's life. Although they went all out for support of direct taxation, particularly for income tax, they did not fail to state that "in the type of economy that we envisage the need for taxation, as we now understand it, will have largely disappeared."[50] Direct taxes were to them only a lesser evil during the transitory period from capitalism to socialism.

Resume

The interwar period witnessed a serious onslaught of the provinces on the presence of the income tax in the federal revenue structure. While the federal government was tossed

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50. Quoted by Mr. Woodsworth in his speech during the budget debate of 1934. Cf. Debates, 1934, p. 2447.

about by recurring political crises, the ordinary citizen was looking to his provincial government for help in his every day needs. Ascendance of provincial authority carried along with it an obvious necessity for expanding revenue sources. The provinces almost succeeded in driving the federal government from the direct tax field toward the end of the twenties.

The gradual retreat of the federal government was reflected in the development of federal income taxation. During the twenties the revenue yield and the incidence of the tax shrunk considerably, making it more or less a nominal levy on the richer class. Small wonder that various groups of income taxpayers joined the provinces in demanding its complete abolition. However, when the government announced its intent to honour these demands the supporters of the tax rallied to its defence, and although being mostly on the left side of the house, induced the government to abandon its original proposal.

The thirties played havoc with both federal and provincial finances. The scramble for more revenues brought about by economic crisis disrupted the Canadian fiscal system seriously. The federal structure, having been remodeled by judicial decisions against the plans of its original framers, did not weather the first storm. After the crisis was over, it was too obvious that Canada had to revamp her federal system were she to be prepared for a similar situation in the future. To this end the Rowell-Sirois Commission received a mandate to investigate the past and to recommend solutions. In essence, they confirmed the federal

principles of the founders of the Dominion, save their taxation arrangements. Here they advised further restrictions on provincial taxing authority. The income tax and death duties were to be levied exclusively by the federal government whereas the increased provincial share in the total revenue should come from federal subsidies. But before the proposals were made public another war broke out which gave a new course to future developments.

CHAPTER IV.

INCOME TAX - A MAINSTAY OF CANADIAN WAR FINANCE

The outbreak of hostilities in Europe in 1939 and ensuing Canadian intervention on the side of Great Britain interrupted the lively debate of intergovernmental fiscal problems which was going on during the hearings of Rowell-Sirois Commission. The bitter reality of war necessitated the strong leadership of the federal government regardless of the results of the Commission's investigation which were at that time in statu nascendi and were published only toward the end of the first war year.

In contrast with the situation created in the fateful year of 1914, this time the federal government was far better prepared in every respect to meet boldly the events as well as to keep the situation well under control from the very beginning of the war. First of all, it could draw upon a costly experience of the past war; secondly, it was in charge of a more developed and diversified economy, having at hand a well organized administrative machinery, and, needless to say, it disposed of excellent experts in every branch of economic science within and without civil service. Furthermore, the extensive research work on Canadian economic history done by the staff of the Rowell-Sirois Commission furnished an excellent point of departure for such a colossal undertaking as World War II.

To be sure, the grasp of the problem by the federal authorities played a major role. Here both Liberal Ministers of Finance,

Mr. J.L. Ralston and Mr. J.L. Ilsley displayed unusual ability. Instead of the fruitless debating of the problems of war finance of Sir Thomas White during the past war, they invited the best brains of the country to do their share in framing the war economic policy and in carrying it into effect as well. The achievements of Canada during the war and the smooth transition to peace-time economic conditions speak for themselves.

Oddly enough, in 1939 the federal government was faced for the second time with a basically identical task, namely, to convert a depressed economy into a war economy, which to a certain degree eased the initial steps. An idle labor force of considerable size[1] could be steered into war production without impairing rolling industries, and without necessity of regulating any sizeable reallocation of resources. Only later on, when the point of full employment was reached, was it imperative to put into operation all necessary brakes as to prevent bottlenecks and inflation.

The situation was perfectly assessed by the government, and the finance policy inaugurated in the first war budget was designed to facilitate, first, the transitory stage and then to maintain rigid controls over consumption and prices as to insure a bigger slice of G.N.P. for war purposes without incurring dangers of inflation. In short, the policy aimed at an adequate credit expansion through government borrowing at the first stage,

1. A.F.W. Plumptre estimated that the number of unemployed at the outbreak of war was 600,000 or 20 per cent of the total working force, agriculture exclusive. Cf. his Mobilizing Canada's Resources for War, Toronto, 1941, p. 13.

and, as soon as the point of full employment was reached, it was proposed to adhere strictly to a pay as you go fiscal policy. This policy was repeatedly reaffirmed in each war budget and on other occasions,[2] and, perhaps until 1942, it

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2. Cf. Debates, 1939-45. The most comprehensive formulation of wartime finance policy was set forth by Mr. J.L. Ilsley during the debate on the Speech from the Throne in the fall of 1940. Answering the strictures of Social Creditors and C.C.F. members he summarized the government policy as follows:

"The principles of our war finance policy have been stated before but will bear repetition. Briefly summarized these principles are:

1. That in real terms, that is to say in terms of loss to the nation of the production required for war purposes, the war is paid for substantially while it is in progress.

2. That the limits of what we can devote to war purposes are not financial but, as previously stated in this house, are physical, mental and moral, that is to say, the physical limits of our resources and the mental and moral capacity of Canadians to bear burdens and make sacrifices.

3. That the task of finance is not to provide the funds which are used to pay for the war services but more fundamentally for economic resources in order that they will be available to the defence or supply department when required.

4. That in discharging this function, finance must keep in step with the defence and supply programme.

5. That for this purpose, taxation, as far as practicable, is a better method than borrowing because it is fairer and final.

6. That taxation should be imposed upon a basis of equality of sacrifice, having due regard to ability to pay.

7. That there are practical limits beyond which taxation cannot be carried, so that the government must also do some borrowing, which should be as far as possible out of voluntary public savings.

8. That the third method of war finance, namely, inflation, is the most unfair, the most uneconomical and the most dangerous of all methods of financing the war.

9. That in the early stages of the war, some expansion of credit is often possible without inflation.

10. That later, as the resources of the country become fully employed, monetary or credit expansion necessarily brings about inflation unless offset by strict counter measures, such as severe taxation. (Debates, 1940, Second Session, p. 281.)

constituted the most impressive feature of Canadian war finance. However, when the war costs reached colossal sums in terms of Canadian possibilities, the government was bound to employ borrowing on a more extensive scale. But it was done largely from the general public in order to preclude the inflationary tendencies which would have resulted were the funds obtained from commercial banks. This is not to say that the government did exhaust every possibility of securing revenues for war purposes by means of taxation, but rather to emphasize the lesson that a total war cannot be financed solely from tax revenue, as heavy as it may be, and that it conditions using up existing savings.

The inauguration of a pay-as-you-go policy envisaged a full application of income taxation for both fiscal and anti-inflationary purposes. The Minister of Finance lived up to his promise and developed the tax into a mighty financial instrument which ever since has maintained its prominent place in the federal revenue structure.

Financing the War.

To set a background for our discussion of income tax developments during the war it will suffice to review briefly in terms of dollars Canadian contribution to the allied cause as well as her mode of paying for it.

Table VIII portrays the steeply rising war costs during the war years, which toward the end reached the stupendous amount of $5.3 billion, wherefrom 80.2 per cent went to direct war

TABLE VIII. A SUMMARY OF DOMINION WARTIME EXPENDITURES, REVENUES AND PUBLIC DEBT, 1940-1945.
(Fiscal Year Ended March 31.)
($000,000)

	1940	1941	1942	1943	1944	1945	TOTAL
EXPENDITURES							
War Expenditures	118	752	1,340	3,724	4,587	4,418	14,939
Nonwar Expenditures	563	497	545	663	735	827	3,830
TOTAL EXPENDITURES	681	1,249	1,885	4,387	5,322	5,245	18,769
REVENUE							
Direct Taxes:							
Personal Income Tax	45	103	296	484	698	768	2,394
Corporation In. Tax	78	132	186	348	311	276	1,331
Excess Profits Tax	-	24	135	435	429	466	1,489
Succession Duties	-	-	7	13	15	17	52
Other	11	13	28	28	28	28	136
TOTAL Direct Taxes	134	272	652	1,308	1,481	1,555	5,402
TOTAL Indirect Taxes	334	506	709	759	956	819	4,083
TOTAL Tax Revenue	468	778	1,361	2,067	2,437	2,374	9,485
Non-Tax Revenue	94	94	127	183	328	313	1,139
TOTAL Revenue	562	872	1,488	2,250	2,765	2,687	10,624
Net Addition to Debt	119	377	397	2,137	2,557	2,558	8,145
Net Public Debt	3,271	3,649	6,183	8,740	11,298	13,421	
Gross Public Debt	4,028	5,018	6,649	9,228	12,359	15,712	

Source: The Canada Year Book.

costs. Taking into consideration a total federal outlay during the six years' war period we get a sum of $20.3 billion in which is included the financial assistance to Britain of $1.5 million (one billion dollar gift and the assistance under the Mutual Aid Act exclusive); non-war expenditures amounting to $3.8 billion and comprising the ordinary expenditures and other charges; and $15 billion of direct war expenditures. The magnitude of those numbers may be better understood when we are reminded that the overall total of federal expenditures for the period between 1914-1939 did not reach the amount expended solely for war purposes between 1939 and 1945, or that the war and demobilization costs of World War I represent only one-ninth of the straight war costs of World War II.

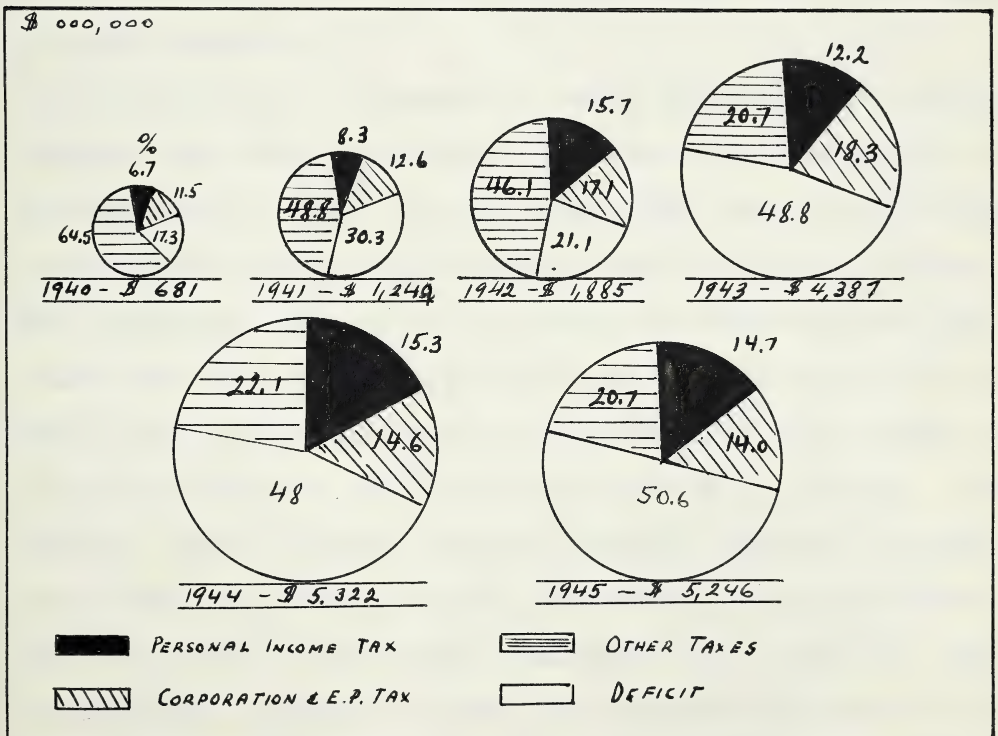
From the $15 billion expenditure, about $1.7 billion was advanced to allied countries during the second half of the war in the form of food, ammunition and war equipment. Besides that, Canada made a gift of one billion dollars to Great Britain to enable her to finance her purchases in Canada, part of which was forwarded through the British government to other Commonwealth countries, and also to Soviet Russia. Thus Canada became the only belligerent country on the side of the Allies which not only did not receive any aid from the United States under Lend Lease, but also, like her southern neighbor, provided assistance to her partners in arms.

It must however, be borne in mind that the figures given in Table VIII are bookkeeping figures arrived at after all adjustments were made, and therefore they do not express exactly the

actual cash requirements of the government during the war years. For example, the financial assistance to Great Britain during the first three war years had to be financed from Canadian cash requirements, although the British government was paying for it by Canadian securities. In other words, the Canadian government had to provide funds for the purchase of those securities which on the government's balance sheet were registered as assets and consequently reduced the over-all total of budgetary deficit.

CHART III.

Percentage Distribution of Dominion Revenue, 1930-45
(Fiscal Year ended March 31)



Source : Based on Table VIII. p.165.

Chart III, together with Table VIII, illustrates the trend of government revenue during the year. The most striking feature of this trend is given by the rapidly increasing proportion of income tax in the volume of tax revenue. At the outbreak of World War II the income tax yielded about half of the revenue derived from combined consumption taxes, whereas at the end of the war this ratio was practically reversed. Equally interesting is the relationship between the total revenue and borrowing which was kept well under control throughout the war.. The budgetary deficit exceeded only in the last war year the amount of total revenue by a small margin of 0.6 per cent, while in the preceding years it was steadily below the 50 per cent mark of total revenues.

In the field of consumption taxes the government introduced comparatively minor increases. The sales tax remained at the pre-war level of 8 per cent throughout the war period, the tariff was readjusted upward but slightly, and the foreign exchange levy was introduced, more or less in order to reduce imports from dollar countries and thus to alleviate the shortage of U.S. dollars. More significant were the increases of excise duties on liquor and tobacco. New taxes were imposed on gasoline, chewing gum, radios, clocks, watches, luggage, jewellry, cameras, toilet soap and travel tickets, automobiles, home appliances, etc. The total revenue from consumption taxes which by tradition could be designed to match the ordinary expenditures of the federal government sufficed for this purpose, and even contributed about one billion dollars for direct war costs.

The bulk of federal funds for war financing came from individuals either in the form of direct contributions or in the form of borrowing. Personal income tax, which netted in the 1939 taxation year only $45 million, bettered its yield after each successive upward adjustment of rates so that in 1945 it contributed the huge amount of $768 million. Similarly, the revenue from the corporation income tax jumped from $78 million up to $742 million, the bigger part of which came from the excess profits tax. As will be seen later, these sums were collected after very sweeping changes in tax rates and exemptions were adopted, putting the number of taxpayers in 1945 above 3 million.

After 1940 the government began tapping the savings of the general public. The organizational task was entrusted to the National War Finance Committee in 1942 when the canvassing job required a nation-wide organization. The N.W.F.C. succeeded or absorbed two special Committees, the War Savings Committee and the Victory Loan Committee which for the preceding two years organized the sale of war savings certificates and stamps and marketed the first Victory Loan. All in all, the Dominion government augmented its net debt on account of war costs and demobilization from $3,152 million to $13,421 million, a four-fold increase. Although this sum might seem very excessive and burdensome, the annual interest charges rose only two and a half times, while the average interest rate fell from 3.52 per cent to 2.54 per cent, and taking into account the increase of revenue,

the debt, despite its size, imposed a relatively smaller burden upon the economy than did the increase during World War I.

Gradual Expansion of Federal Income Taxation.

The enunciation of a pay-as-you-go policy for financing the war represented a marked departure from the traditional Canadian fiscal policy. It required an extensive use of direct taxation by the Dominion government which not long ago was a cause of serious frictions between federal and provincial governments. Therefore, Mr. Ilsley introducing the first war budget in his capacity of Acting Minister of Finance on September 12, 1939, devoted considerable time to justifying this policy. After reviewing past experience in war finance, he assured the House that past mistakes would be avoided. Alluding to direct taxation as the most ideal method of distributing the war burden according to the principle of equality of sacrifice or of ability to pay, he stated that the government was aware of its limits. In particular he said:

> "We shall not, of course, be able to meet all war costs by taxation, because... there is a limit to the taxes that can be imposed without producing inefficiency, a lack of enterprise and serious discontent... We cannot carry taxes beyond the point where they seriously interfere with production. But we are not prepared to be timid or lighthearted in judging where this limit lies. What we cannot meet by taxation, we shall finance by means of borrowings from the Canadian public at rates as low as possible." 3

As the Minister pointed out, this principle was a long-range view. The immediate situation called for a mild expansion of

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3. Debates, Sept. 12, 1939, p. 140.

credit and consequently the government was prepared to meet the first costs by means of short borrowing from the banking system. Such a solution had also the advantage that it did not entail a retroactive revision of income tax, for the gap between the rate increase and collection of tax revenue was thereby filled, and also it enabled the government to await the final recommendations of the Commission on Dominion-Provincial Relations.

The budget contained the following amendments in respect of income tax: firstly, personal incomes were made liable to a flat war surtax of 20 per cent of the tax payable; secondly, the corporation rates were increased from 15 per cent to 18 per cent and from 17 per cent to 20 per cent on incomes of corporations filing normal and consolidated returns respectively; and thirdly, patriotic donations up to 50 per cent of net taxable income were allowed as deduction.

The Minister also introduced the excess profits tax on war business profits effective from that date. Business concerns were allowed to elect to be taxed on either one of two bases, namely, either on the basis of a graduated scale of profits on capital employed, or on the increase in profits over the average of the past four years. Under the first alternative, a business concern was obliged to pay a 10 per cent rate on profits ranging from 5 per cent to 10 per cent of capital employed, 20 per cent on a 10%-15% range, 30 per cent on a 15%-20% range, 40 per cent on a 20%-25% range, and 60 per cent on profits in excess of 25 per cent of employed capital. Under the latter alternative, the

rate was 50 per cent of the profits in excess of the four-year average. The corporate income tax was allowed as an expense in calculating the amount of excess profits for tax purposes. However, the law was repealed in its entirety in the subsequent year and supplanted by a new law.

Despite the substantial rate increase, the revenue yield of the income tax slid down by $8 million, mostly due to the business activity in 1939, which did not pick up until the end of the year.

The first spell of heavy income taxation approached in the second war budget. The general economic conditions had improved more rapidly than was expected, which in turn made possible the imposition of further burdens upon the economy in the form of taxation. During the next ten months about 100,000 unemployed were put to work, and business activity was humming due to large orders of the Dominion government and British government . Farmers harvested in 1939 a heavy wheat crop, thus bettering their share in the increase of national income.

The budget of 1940 was delivered late in June, when the nation was already prepared psychologically also to accept heavier taxes. The income tax amendments were, of course, the highlights of the budget speech. The scope of the tax was materially broadened by drastic reductions in personal exemptions, rates increased, and a new tax, the National Defence Tax, introduced.

Amendments affecting Personal Income Tax.

Statutory exemptions granted to individuals were lowered to

$750 and $1,500 for single and married persons respectively, while the allowance for dependents remained unaltered and was extended as to apply to children evacuated from Great Britain under a governmental scheme.

All existing tax rates applicable to individuals were abolished and replaced by new schedules. The normal tax was replaced by the National Defence Tax, which will be discussed separately. The uniform graduated tax imposed on all incomes in excess of personal exemption started with 6 per cent on the first $250 or any part thereof. The income over $250 but not over $1,000 was charged with an 8 per cent rate, plus $15, which then steeply progressed up to 78 per cent plus $304,765, that being the tax on incomes in excess of $500,000.[4] No special tax rate was imposed on investment income. All residents of Canada were liable to a 5 per cent rate in respect of income from interest and dividends received in currency which was at premium in terms of Canadian dollars. Further, the withholding tax rate was increased to 15 per cent of the net income of non-residents received for services rendered in Canada, whereas their income derived from royalties, rentals and similar payments was charged with a 5 per cent rate upon the total amount.

National Defence Tax.

The amending statute (4 Geo. VI c.34) inserted a new Part XV into the Income War Tax Act, 1927, which charged all individuals with a new National Defence Tax. The basic personal exemptions

4. For details see Statistical Appendix, Table E.

were fixed at $600 for single persons and $1,200 for married persons, hence substantially below the exemptions granted for graduated income tax. Single persons were liable to a 2 per cent rate in respect of income in excess of $600 but not in excess of $1,200, and to a 3 per cent rate on income above the latter limit. Married persons and persons having similar status paid a straight 2 per cent rate on all net income in excess of the basic exemption. Inasmuch as the tax had to be deducted at the source, the law imposed an extra levy upon those incomes where the tax was not so deducted. If the tax was over $25 but not over $100 an extra levy of one dollar was added, for the tax up to $200 the levy was $3. It was then increased by additional three dollars until it reached $21 which was to be added to the tax in excess of $700. A deduction of $8 was allowed from the tax in respect of dependents. Specific provisions exempted from tax liability corporations and joint stock companies, all persons exempted from the income tax, municipalities, and military personnel. The statute provided further that the National Defence Tax must not reduce the income below the basic exemption; in other words, if the income of a single taxpayer was $610, he was obliged to pay only $10 instead of the full liability of $12.20.

Amendments Affecting Business.

The 3 per cent increase in corporation tax rates applicable to 1940 incomes was preserved, but the 12 1/2 per cent withholding charge on income of non-resident corporations derived from

royalties, rentals and similar payments was increased to 15 per cent of gross receipts. Partners or proprietors of a business enterprise paying Excess Profits Tax were allowed to deduct a proportionate part thereof from personal income when computing personal tax liability.

Sundry Provisions.

The amending law eliminated the statutory exemption of $1,200 granted to Dominion annuities and like annuity contracts entered into after June 25, 1940, or to enlargements of existing contracts, but the exemption granted to existing contracts was preserved. Distributions of the income of family corporations became taxable if effected after December 31, 1942. The law contained further provisions designed to prevent tax evasion which need not be discussed here, save one. In 1940, the Treasury Board was empowered to make rulings in respect of the tax liability of any transaction which was effected for the purpose of tax avoidance or reduction of tax liability. This provision in amended form was also later incorporated into the present Income Tax Act.

Excess Profits Tax.

Since business profits were taxed chiefly during the war under the Excess Profits Tax Act, a brief reference to this Act seems to be in place. As we have mentioned earlier, the Act adopted in 1939 was repealed and substituted by a new one. The Excess Profits Tax Act, 1940, followed in its principles the British practice. It levied a tax of 75 per cent on the excess

profit of the 1936-39 average with a proviso that the minimum tax could not be less than 12 per cent of total annual profits. Small business with profits below $5,000, n.r.o. investment companies, personal corporations and professional businesses were exempted.

The final decision as to the average profits rested in some cases with the Minister of Finance, and in certain cases with a Board of Referees instituted by the Act. The determination of taxable profits for the purposes of Excess Profits Tax was based upon the same principles as for the purposes of normal corporation tax with certain deviations. For example, a corporation was allowed to make a reasonable deduction for a reserve for future depreciation of inventory values, or in case of proprietors or partnerships an allowance not exceeding $5,000 was permitted in lieu of salaries paid to the proprietor or to the partner working full time. Also, the corporation tax paid on the excess profit was made deductible as to eliminate double taxation. The Excess Profits Tax was applicable to profits earned since January 1, 1940 and thereafter.

The impact of the aforementioned revision of personal tax rates is illustrated on the accompanying Table IX.

The most substantial increases were those affecting the low and middle income brackets, where the tax was raised several times. As has been pointed out earlier, in Canada there are relatively few income receivers above the $25,000 level. Therefore, the Minister had to bring within the scope of income tax primarily those below that level, were the tax yield to increase

Table IX.

INCOME TAX PAYABLE UNDER THE RATES OF 1939 and 1940
ON SELECTED INCOMES.
(Married person with no dependents)

Income	Income Tax (1939 rates)	Income Tax (1940 rates)	U.K. Income Tax 1 = $4.45
$1,500	-	$30	$141
2,000	-	75	328
3,000	$36	195	703
4,000	84	355	1,078
5,000	144	555	1,453
10,000	781	2,170	3,550
15,000	1,789	4,330	5,993
20,000	3,112	6,530	8,715
30,000	6,514	11,200	14,796
50,000	14,351	21,610	26,943
100,000	39,299	51,520	66,547
150,000	70,043	84,475	108,265
200,000	103,698	119,430	150,765
500,000	334,653	357,235	405,765

Source: Budget Speech, 1940.

substantially. However, it must be borne in mind that Canadian taxpayers were subject also to different provincial and municipal income taxes which somewhat increased their over-all tax liability. The Minister of Finance estimated in his budget speech that a resident in Ontario would pay about 90-98 per cent of the British levy on his 1940 income in the aggregate of Dominion and provincial income taxes.

Alluding to the chaotic situation in the income tax field across the country, the Minister saw in it the chief obstacle to any sane federal fiscal war policy, for it not only precluded adoption of adequate income tax measures on the side of federal authorities but also it distributed the tax burden in a very un-

even way among various parts of the country. Since the Rowell-Sirois Report was at that time made public, and the federal government was about to call a Dominion-Provincial Conference to deal with its main recommendations, the solution of overlapping income taxes was postponed until the next year when the position of the provinces on the Sirois Report was expected to be clarified.

Unfortunately, the Conference, convening in Ottawa early in 1941, collapsed after two days since some provinces refused even to discuss the proposals of the Royal Commission. Mr. Ilsley, who in the meantime succeeded Mr. Ralston in the finance portfolio, approached the question of overlapping income taxation from an entirely different angle. In his budget of 1941 he proposed a federal tax on incomes calculated on the assumption that the provinces were not in those fields, and proposed as a temporary expedient, to ask the provinces to vacate the income tax field. As a compensation to each agreeing province he offered to pay for the duration of war either (a) the revenue which the province and its municipalities actually obtained from these sources during the fiscal year ending nearest to December 31, 1940, or (b) the costs of the net debt service actually paid by the province during the fiscal year ending nearest to December 31, 1940, (not including contributions to sinking funds), less the revenue obtained from succession duties during that period. The Minister gave the provinces a solemn assurance that the question of the Sirois Report would not be reopened

until after the end of the war, as well as that the plan outlined above was strictly a war expedient and would be discontinued within one complete fiscal year after the termination of hostilities.[5]

On this basis of "give and take" the provinces entered into tax agreements with the Dominion,[6] thus freeing the federal authorities to devise and impose a federal income tax as they thought fit into their fiscal policy.

The budget resolutions, besides including a further rise in income tax rates and in the gift tax rates, introduced for the first time succession duties into the federal revenue scheme on a basis akin to the existing provincial inheritance levies, completed the long process of transforming the federal fiscal system along the lines of direct taxation, which has remained unaltered up to the present time.

Amendments Enacted in 1941 in Respect of I.W.T.A.

The more important amendments affected the distinction between earned and investment income, personal tax rates, National Defence Tax, gift tax, and the withholding taxes.

The $14,000 limit imposed upon earned income in 1935 was abolished, leaving the source of income as the only dividing line between earned and investment income. According to the new

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5. Cf. Debates, 1941, p. 2344.

6. The amount paid by the Dominion to the provinces under the Tax Rentals Agreement Act, 1942, totalled $86 million a year.

provisions, investment income comprised any income which could not be explicitly subsumed under the definition of earned income. The alternative exemptions granted in the previous law were restricted to either investment income up to $1,500 or to the total personal exemptions allowed on account of personal statutes and dependents, whichever was higher. The old graduated surtax on investment income was repealed and substituted by a flat 4 per cent levy.

The rates applicable to individuals were further increased. The new schedule imposed a 15 per cent rate on the first $1,000, 20 per cent plus $150 on the additional $1,000 and so up to the $500,000 income which was charged with $358,580 plus 85 per cent on income in excess of that bracket.[7] The withholding tax charged in respect of non-resident individuals in receipt of interest, dividends, rents, royalties,[8] etc. was put on a 15 per cent basis so that all income going abroad was subject to a uniform rate. Certain alleviations were however, granted regarding payments for motion picture films and interest on provincial bonds.

The national defence tax was markedly increased as well. The low rates of 2 and 3 per cent applicable since June 30, 1940, were raised to 5 per cent on income between $660 and $1,200, and to 7 per cent above the latter in the case of a single person, and to 5 per cent upon income in excess of $1,200 in the case of

7. See Statistical Appendix, Table E.

8. Rentals from real estate were taxed on the net income, whereas other income was taxed on the gross income.

married persons or having similar status. The tax credit for dependents was fixed at $4 for 1940, at $14 for the year 1941, and at $20 for 1942 income and thereafter. The provision that the tax must not reduce the basic income remained unaltered. The extra tax imposed when the national defence tax was not deducted at the source amounted to one dollar if the tax was over $25 but not over $100, and 3 per cent thereof if the tax exceeded $100. As might have been noted, the basic personal exemption for single persons was raised to $660, for, as the minister stated, the heavier rate was too heavy right at the bottom in cases of single persons living away from home. Further provisions regulated the residence requirements, taxation of income from trusts, allowance for Excess Profits Tax, and the time of filing returns.

The corporate tax remained unaltered save the N.R.O. companies which were made subject to 22 1/2 per cent rate instead of the previous one-half of corporation rate.

Other provisions were adopted, which, reduced the amount of donations deductible to 10 per cent and 5 per cent of taxable income of individuals and corporations respectively, and removed the tax exemption from payments from superannuation and pension funds over 5 per cent of the total amount. The tax credit for taxes paid to foreign countries was also changed. Some changes were made in gift tax rates.

Excess Profits Tax.

The minimum tax on total profits of 12 per cent for the

period January 1, 1940 - December 31, 1940, was increased to 22 per cent in the case of corporations and to 15 per cent in the case of all other businesses effective as of January 1, 1941. The maximum tax on excess profits remained unaltered at a 75 per cent rate.

There were numerous changes adopted regulating in detail the standard period, standard profits, deductions, exemptions, credit for taxes, depletion and depreciation, inventory reserves, etc. They were chiefly designed to remove the rigidity of the original law, particularly in respect of depressed business.

The 1942 Amendments.

The upward trend of war income tax revisions reached its culminating point in 1942 when the Minister of Finance imposed the highest rates in Canadian income tax history. The rates became applicable to 1942 and subsequent incomes, but because in 1943 half of the 1942 tax was forgiven in connection with adopting a pay-as-you-earn plan of collection, they remained in force for the only year of 1943, which became the most trying year for the Canadian taxpayer in the whole history of the Dominion.

The adoption of such heavy imposts is explained by two developments. Firstly, all provincial governments accepted the offer of the Minister of Finance, and vacated the field of income taxation for the sole use of the federal government. Secondly, the war entered its fourth year with undiminished

destructive power, and the heavy losses of European Allies necessitated heavier contributions of overseas countries, in both manpower and in materials. Since October, 1941, the country lived under over-all controls of prices, wages, and consumption, and to prevent the spread of black markets it was deemed necessary to reduce the purchasing power in the hands of public by means of heavier taxation and borrowing, and thus to counteract the development of inflation.

After reviewing the 1941 financial situation of government accounts and expected further increases in war expenditures, Mr. Ilsley went on in his budget speech:

> "From what has been said it is evident that fiscal necessity forces us to look again to the income tax on individuals, or some similar device, for a large amount of additional funds. In devising measures to meet this need I have had to keep in mind three other important considerations - the need for equity, for incentive, and for savings." 9

What a change against the past! In 1915, Sir Thomas White alluded in very similar terms to the customs duties,[10] which until the beginning of the war 11, were the chief source of federal revenues. In the 1940-41 fiscal year the income tax was already the second most important source of revenue, and since the fiscal year now under review it has become by far the most important revenue producer in the federal revenue system.

<u>Income Tax Amendments</u>.

The salient features of the 1942 changes in the income tax in-

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9. <u>Debates</u>, 1942, p. 3579 ff.
10. Cf. Chapter 11, p. 47.

cluded a new schedule of rates, a new method of allowances for married status and dependents, adoption of a refundable tax, pay-as-you-earn plan of tax collection, and an upward revision of gift tax rates.

New Tax Rates Adopted.

The national defence tax was discontinued as a separate levy and instead of it a "normal tax" with higher rates was incorporated into Schedule I.

The graduated tax upon net incomes of all persons other than corporations and joint stock companies was levied according to the following schedule:

On the first $500 of income or any part thereof 30%

or

$150 and	33%	on income over	$500	but not over	$1,000
315	37%		1,000		2,000
685	41%		2,000		3,500
1,300	45%		3,500		5,000
1,975	50%		5,000		8,000
3,475	55%		8,000		13,000
6,225	60%		13,000		20,000
10,425	65%		20,000		30,000
16,925	70%		30,000		50,000
30,925	75%		50,000		70,000
45,925	80%		70,000		100,000
69,925	85%	on income over	100,000		

For purposes of normal tax only the amending law (6 Geo.VI, c.28) granted $660 and $1,200 as a basic exemption for single and married persons, whereas for purposes of the graduated tax the basic exemption was $660 for all taxpayers regardless of status.

The previous system of deductions from net income on account of status and dependents was substituted by a new scheme based

on fixed deductions from the tax payable. The taxpayer in computing his normal tax liability was allowed to deduct $28 from the normal tax for each dependent, child, parent, or as the case may be. From the graduated tax he was permitted to deduct (a) $150 on account of married status; (b) $80 on account of dependent child or grandchild under 18 years of age (under 21 years of age in the case of students, and above this limit in the case of a dependent child incapable of self-support), and for each child supported under the co-operative scheme sponsored by the governments of the United Kingdom and Canada; (c) 20% of the graduated tax but not exceeding $400 for grandparent, brother or sister dependent upon the taxpayer. Together with the provision that the aggregate of both taxes must not reduce the basic income of the taxpayer, the "freezing" of personal deductions gave some alleviation to lower income receivers, but somewhat stiffened the tax liability in the higher brackets.[11] Since the personal deductions from net income were abolished, investment income was made taxable in excess of $1,500 regardless of personal status at the old flat rate of 4 per cent.

A specific feature of 1942 legislation was Part XVII providing for refunding a specified amount of tax paid under the changing schedules of income tax law at certain dates after the end of the war. In essence, the total tax included the

11. The deductions from the tax on account of dependents were calculated on the basis of a $3,000 income of a taxpayer. Thus those below this average gained somewhat, and those above it paid somewhat more.

absolute tax plus the refundable portion called also "minimum saving requirement". The refundable portion amounted to 8 per cent of the tax or $800 whichever was less in the case of a single person, and 10 per cent of the tax or $1,000 in the case of persons having married or equivalent status, plus either one per cent or $100 for each dependent. The government stipulated it would pay 2 per cent interest on these amounts until their refunding. Persons over 65 years of age were exempted and could deduct the proper amount from the tax otherwise payable. Also payments for superannuation or pensions, life insurance premiums, annuity premiums, principal payments on a mortgage or agreement for sale of a taxpayers' residence effected prior to June 23, 1942, were offsets to the minimum saving requirement and a taxpayer could claim these as a deduction from the tax up to the limit of the whole refundable amount.

Further provisions granted an additional deduction from net income for medical expenses exceeding 5 per cent of the net income provided that the maximum amount deductible should not exceed $400 in the case of a single person and $600 in the case of married persons plus $100 in respect of a dependent with a limit of $400 for all dependents. Section 9B (income of non-residents) was extended as to make the gross amount paid to non-residents in the form of salaries, wages, and other fixed and determinable incomes liable to tax, so that income of non-residents of whichever form was charged on its gross

rather than net income. A complete tax exemption was granted war pensions and workmen's compensation receipts, and a limited exemption to certain classes of military personnel. Further amendments were effected in respect of taxing pension funds, deduction of business losses, and certain amounts paid under the Excess Profits Tax Act.

A marked innovation was adopted in respect of tax collecting. Heretofore the discontinued national defence tax was the only levy to which applied the statutory obligation of withholding the tax at the source. The other tax levies, although permitted to be paid in advance by way of instalments since the preceding taxation year, regularly became due only after the return had been filed. The 1942 amending law inaugurated a general system of withholding of all income tax levies at source all regular and fixed incomes. Beginning with the taxation year 1943, employers were required to file on or before October 15, information returns of salaries and wages paid to their employees, and beginning with September 1, 1942, to deduct from salaries and wages, and remit to the Receiver-General such percentage as the regulation would state. After the end of a fiscal year, a taxpayer was therefore liable only to the excess over the amount paid by instalments. The advantage of this system was twofold: on the one hand, it assured a steady flow of income to the treasury, and on the other hand, the taxpayer was fulfilling his tax obligation as the income accrued to him. As to the tax incidence, it removed the time

lag between the earning process and assessment, thus strengthening the good as well as bad effects of income taxation.

Excess Profits Tax.

A similar drastic upward revision of taxrates was effected also in the excess profits tax. The former 22 per cent minimum tax was divided into two parts: a 12 per cent rate applied to the total profits irrespective of the extent to which they might have increased, and the remaining 10 per cent was used as the alternative minimum rate applicable to excess profits. The maximum tax rate previously at 75 per cent was fixed at 100 per cent. To alleviate the tax burden the businesses paying a 100% tax on their excess profits were allowed, firstly, to deduct a proportionate part of corporation income tax and the basic excess profits tax (12%) from the additional tax payable (100%), and secondly, the taxpayers enjoyed the privilege of obtaining a 20 per cent refund at a specified date after the termination of war. The amount to be refunded was defined by Section 18 as being 20 per cent of profits above the point at which the alternative minimum and maximum levys were equal, viz. above the point where profits were equal to 116.66% of the standard profits.[12]

Other provisions of the law dealt with standard profits, deductions, profits of small business, and particularly the old principle of exempting new minimg companies for three calendar

12. 10% of $116.66 is equal to $16.66 minus $5.00 (being 30% of $16.66). For companies filing consolidated returns the point was fixed later at 117.22 per cent.

years from tax liability was extended for the third time.[13]

Gift Tax.

The schedule of tax rates applicable to gifts adopted in the previous year was revised upward in 1942. It was carried unaltered into the Income Tax Act, 1948, and has remained in force until to-day. Both schedule are reproduced below.[14]

Section 88 of I.W.T.A. charged gifts with a tax as follows:

		Taxation Year 1941	1940
On gifts up to and including	$ 5,000	10%	7%
On gifts over			
$ 5,000 but not over	10,000	11%	8%
10,000	20,000	12	9
20,000	30,000	13	10
30,000	40,000	14	11
40,000	50,000	15	12
50,000	75,000	16	13
75,000	100,000	17	14
100,000	150,000	18	15
150,000	200,000	19	16
200,000	250,000	20	17
250,000	300,000	21	18
300,000	400,000	22	19
400,000	500,000	23	20
500,000	600,000	24	21
600,000	700,000	25	22
700,000	800,000	26	23
800,000	1,000,000	27	24
1,000,000		28	25

The tax became due on April 30th of the succeeding year, and bore interest at 8 per cent, 2 per cent higher than the normal income tax.

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13. A brief summary of successive Excess Profits Tax amendments may be found in CCH Canadian Ltd., Income War Tax Act, 1946, Toronto, 1946.

14. Cf. Statutes of Canada, c. 18, 1940-41, and c. 28, 1942-43.

The heavy income tax elicited some murmurings of being too burdensome, and as Table X indicates, the personal income tax was more than quadrupled in the low brackets between 1940 and 1942, while in the upper brackets the increase was percentually less steep. It was the labor and farming groups, falling into the low income brackets, who were complaining most. Mr. Ilsley was perhaps best aware of the burden he had imposed upon the taxpaying public. He admitted in his budget speech that the taxes would reduce the standard of living of all Canadians, but he said "the war will be not won by disputing as to whether labor or agriculture or employer or employee should get a larger share of a swollen national income". It will be shown later that Canadian tax rates were highest in the middle brackets, as compared with those employed in Great Britain, and the U.S.A. during the same period. However, since then each successive year brought gradual alleviation of the tax burden and thus reduced the strictures of the public.

Lessening the Tax Burden.

Since 1943 the government gradually has reduced the tax load by means of extended deductions. In 1943 the Minister announced forgiveness of a half of the tax payable on 1942 incomes in connection with putting the system of tax collection on a comprehensive pay-as-you-earn basis. The regulations governing the deduction at source was published late in 1942, and employers would have had to deduct in the 1943 taxation year both the overdue payments on 1942 income as well as the deduction

TABLE X. Personal Income Tax Payable at Various Income Levels in 1940, 1941 and 1943 Taxation Years.

(Persons with single and married status, no dependents)

Income before Exemption(d)	1940		1941		1943 (=1942 Rates) (a)		(b)	
				Single Person				
$1,500	$77	5.1%	$187	12.5%	$247	16.6%	$367	24.5%
2,000	135	6.7	300	15.0	441	22.0	601	30.0
3,000	280	9.3	562	18.7	824	27.5	1,064	35.5
4,000	465	11.6	875	21.9	1,274	31.8	1,594	39.8
5,000	690	13.8	1,232	24.6	1,728	34.5	2,128	42.6
8,000	1,567	19.6	2,470	30.9	3,225	40.3	3,865	48.3
15,000	4,327	28.8	5,977	39.8	7,579	50.5	8,379	55.9
100,000	51,197	51.2	61,547	61.5	79,537	79.5	80,337	80.3
200,000	118,652	59.3	136,995	68.5	175,504	87.7	176,304	88.1
				Married Person				
$1,500	$15	1.0%	$52	3.5%	$100	6.7%	$200	13.3%
2,000	55	2.7	145	7.2	231	11.5	431	21.5
3,000	165	5.5	355	11.8	584	19.5	884	29.5
4,000	315	7.9	615	15.4	964	24.1	1,364	34.1
5,000	505	10.1	925	18.5	1,378	27.5	1,878	37.6
8,000	1,295	16.2	2,060	25.7	2,755	34.7	3,555	44.4
15,000	3,960	26.4	5,400	36.0	6,929	46.2	7,929	52.9
100,000(c)	50,300	50.3	59,575	59.5	77,187	77.2	78,187	78.2
200,000(c)	117,210	58.6	133,470	66.7	171,154	85.6	172,154	86.1

Source: Dominion-Provincial Conference on Reconstruction, Reference Book, Personal Income Taxes, p. 24-25. See also Debates, 1942, p. 3582.

(a) Not including "Refundable Portion".
(b) Including "Refundable Portion".
(c) Considered as 50% "investment income", except in 1940 when all income over $14,000 was deemed to be investment income for tax purposes.
(d) "Earned Income" except per footnote (c).

on 1943 incomes. This would cause serious hardships for all but the high income receivers. The relief applied in full to the tax on earned incomes, and investment income up to $3,000, while investment income above this level remained liable for the full amount with a proviso that a half of the tax payable became due only after the death of the taxpayer, and then it was to be paid from his estate, or it could be defrayed prior to April 30, 1944 at a discount. This privilege did not apply to revenues paid to non-resident persons, as well as to gift taxes.

Further, the ceiling regarding "basic income" in the bottom brackets was somewhat extended. Single persons having an income up to $820 or married persons up to $1,570 were required to pay only the maximum of two thirds of the amount by which the total income exceeded the basic exemption. Some relief was given also to military personnel and to receivers of Dominion government annuities.

More favourable treatment was afforded to business and farm losses, and costs incurred by prospectors for strategic metals, oil and natural gas.

Section 32A, vesting discretionary powers in the Treasury Board, was further amended extending the discretion of the Board to transactions involving inter-company distribution of dividends and stock conversions.

The income of employees of Canadian firms temporarily sent abroad, per diem allowances, and profits realized from sale of assets subject to an accelerated depreciation were made

taxable. Indeed, the amendments extending the method of tax collection were of prime significance. In addition to further changes in the rules applicable to the income of wage and salary receivers and the income of non-residents, a provision was adopted requiring farmers to pay two-thirds of their tax calculated any time up to December 31, on the basis of a rough guess, and the balance when they filed the annual return. It was estimated, that since 1943 the pay-as-you-earn method covered about 95 per cent of all collections.

The budget of 1944 continued the downward revision of the income tax. Presentations were made to the Minister of Finance that heavy income taxes exerted an adverse effect on production, particularly that they increased absenteeism, curtailed the willingness to do over-time work, and thus induced employers to use various devices to provide wage increases. Mr. Ilsley therefore proposed further tax relief in his budget speech of June 26, 1944, deliverance of which was evidently timed with its proposals. Firstly, the saving portion of the tax for individuals was terminated effective June 30, and persons reaching the age of 65 years could claim immediate refunds if their income was less than $5,000. Secondly, medical expenses incurred abroad became deductible as if they were incurred in Canada, and the maximum amount deductible was increased by one-half in each case and the 5 per cent limit was put at 4%. Thirdly, the definition of "dependent child" was extended as to include an illegitimate child, and the alimony paid pursuant to a divorce or separation

decree or to similar arrangements were permitted as a deduction from payor's income. Fourthly, a taxpayer was allowed to reduce his income for income tax purposes by a straight cash donation to the Dominion government within a specified period of time. This provision was inserted in order to grant some relief to husband and wife where either of them had a small investment income above the basic personal exemptions.

In the sphere of the corporation income tax and the excess profits tax a marked innovation was introduced in the form of carry-over of business losses (three years) and carry-back of expenditures incurred for repairs and maintenance (as far back as December 31, 1942). Similarly, expenditures on research of a current nature became deductible expense in the year of expending, and expenditures of a capital nature were deductible over a period of three subsequent years. The allowance for costs of prospecting was also broadened.

The steep increase of income tax rates exposed the inequalities of treatment of different kinds of incomes. Taxation of co-operatives, credit unions, of distribution of earnings of closely held companies accumulated prior to 1939 posed serious problems to the administration, over-loaded with work, which could not devote much time to their revision. Consequently, Mr. Ilsley announced in his budget speech in 1944 that those special income tax problems would be subjected to an exhaustive study by two Royal Commissions. Soon afterwards the government appointed a Commission, headed by W.C. Ives, to inquire into the taxation of annuities and family corporations, and another with

Mr. E.M.W. McDougall as a chairman to investigate the taxation of co-operatives. Of course, this was just the beginning of a close scrutiny of the workings of the Income War Tax Act, which was carried on by different public bodies and which finally resulted in adoption of a new income tax law in 1949.

With the budget of 1944 war finance was in a sense concluded. In the next year hostilities ended, and budget of 1945 was not brought down until late in the fall, when the new problems of reconstruction and adaptation to peacetime conditions came to the fore. This period will be reviewed in the next chapter, but before we would focus our attention to the postwar years, it is necessary to devote some space to the broad economic aspects of war taxation.

Income Tax as an Anti-inflationary Instrument.

From the very beginning of the war the government pursued two main objectives in its financial policy. First, it wished to secure as much revenue as possible for financing the war costs from taxation and secondly it wished to use heavy taxes as a check on the price level. The first aspect we have discussed at the beginning of this chapter, and it was asserted that the government was definitely successful in attaining this objective. Now we are about to answer the second question, viz. how effectively did the taxation policy work in checking inflation?

It must first of all be pointed out that taxation policy was by no means the sole check, but rather a complementary

device employed together with borrowing policy and over-all regulation of prices, wages, and production. Taxes and borrowing were absorbing excessive purchasing power in the hands of consumers, and balanced the demand for goods and services to their supply which war industry could produce for civilian consumption.

Table XI. Gross National Product, Net National Income, Personal Income, and Income Tax Collections, 1939-45.
(In Millions of Dollars)

Year	GNP	NNI	Personal Income	Income Tax Collections Total	Personal Income Tax	% Ratios 5/3	5/2	6/4
1	2	3	4	5	6	7	8	9
1939	5,707	4,373	4,320	261	46	5.9	4.8	1.07
1940	6,872	5,263	4,947	398	71	7.1	5.7	1.44
1941	8,517	6,563	5,896	736	226	11.2	8.6	3.84
1942	10,539	8,337	7,475	1,061	432	12.7	10.0	5.64
1943	11,183	9,043	8,176	1,270	630	14.0	11.3	7.64
1944	11,954	9,826	9,002	1,209	711	12.2	10.1	8.56
1945	11,850	9,940	9,235	1,332	733	13.3	10.7	7.98

Source: D.B.S., National Accounts, Income and Expenditure, 1926-50, Tables 5, 18 and 38.

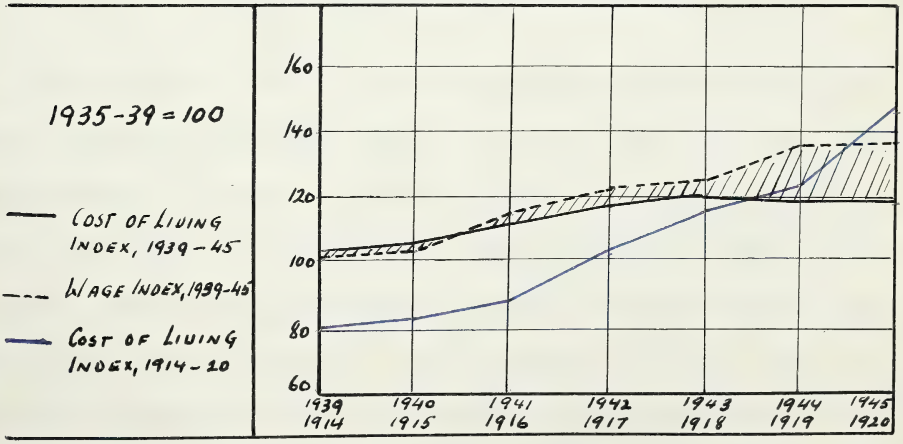
The increase of GNP during the war years was chiefly attributable to the fuller use of the existing capacity, prior idle, to the establishment of new plants, and also to extended working hours of the labor force. Canada was able to expand her output of goods and services by such speed that the needs of war exercised considerably smaller pressure on civilian consumption which, despite war conditions, rose. Perhaps here lies the major reason for the small changes in the wholesale price index which

moved upward from 75.4 points in 1939 to 105.6 points in 1945 when it more or less returned to its 1926 normal level. Similarly, the cost of living index jumped by only 18 points during the same period. The largest increase occurred during 1940-42 when neither economic controls nor taxation were put into full operation. But although Professor Higgins pointed out in his study on Canada's war finance, that price indexes and cost-of-living indexes are not very reliable guides when judging the inflationary trends during a war,[15] nonetheless they may reveal the relative effectiveness of a government's measures adopted to counteract such trends.

In the immediate postwar period both indexes rose sharply, as controls were removed, the liquid assets accumulated during the war spilled over into the market for goods, and income taxes were lowered. In 1947, the wholesale index number reached

CHART IV.

Cost of Living Index, 1914-1920, and 1939-1945; Wage Index, 1939-1945. (Yearly averages.)



Source : The Canada Year Book.

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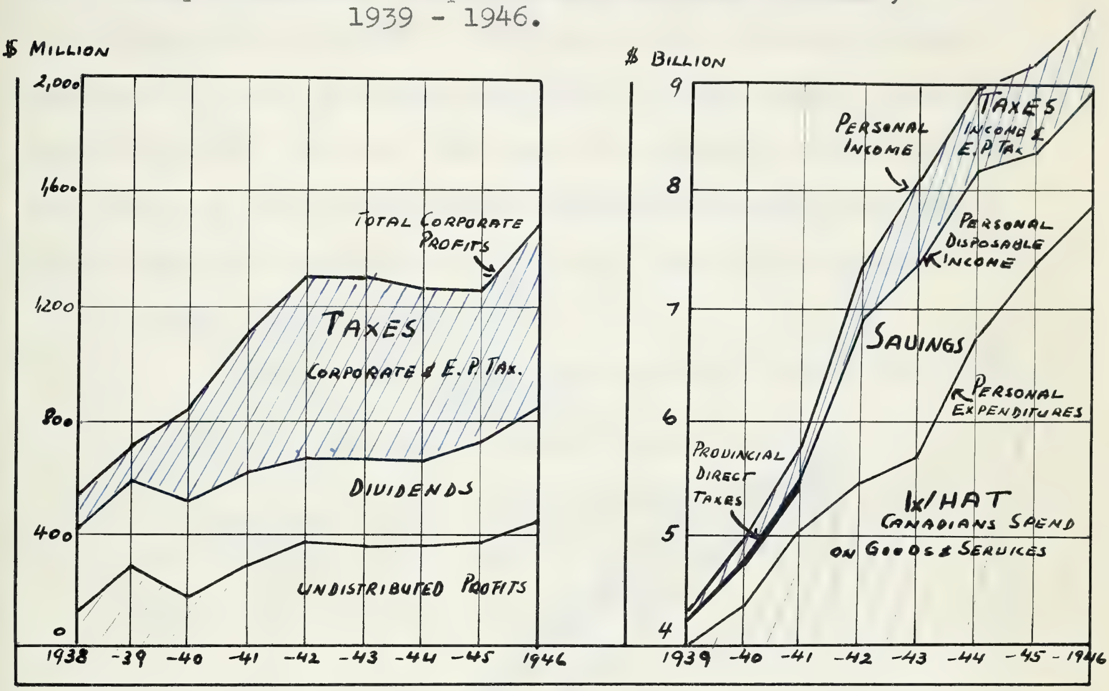
15. Higgins, op. cit., p. 3.

the height of 129.1 and the cost-of-living index 135.5 points and still kept on rising.

CHART V.

Compononents of Corporate and Personal Income , 1939 - 1946.



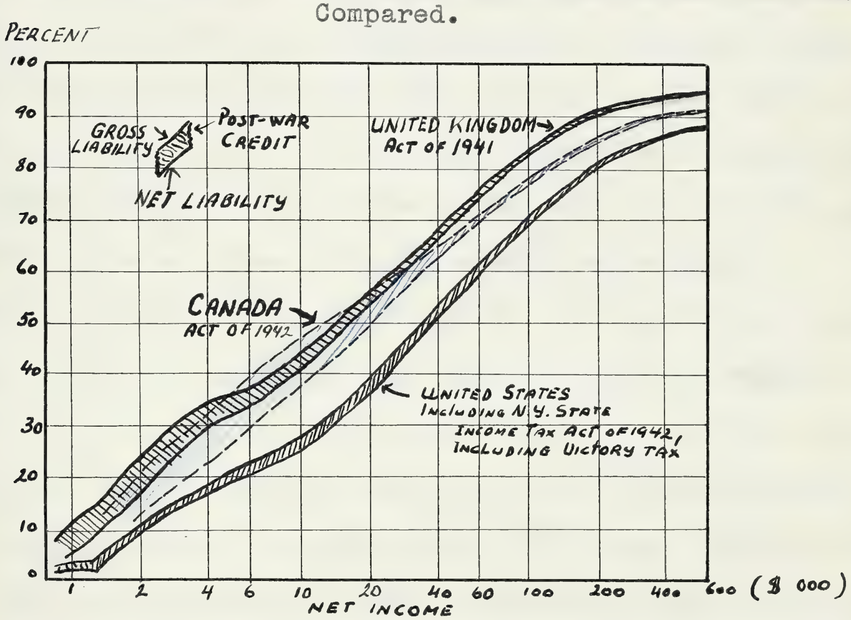
Source : D.B.S., National Accounts, Income and Expenditure, 1926 - 50.

The corporate income tax and excess profits tax exercised a much stronger influence upon corporate earnings than on personal incomes. Chart V indicates that the total amount of corporate undistributed profits and dividends was kept almost on the same lewel during the war by means of heavy taxes which absorbed more than a half of total profits. In the case of individuals the picture is less impressive, particularly for the last part of the war. As long as the government was adhering to the

pay-as-you-go policy, the expenditures on goods and services reflected the general trend of increasing economic activity. However, since 1943, when the first tax relief was granted, the volume of personal expenditures was rising steeply. In this connection it may be of interest to note that the announcement of the Minister of Finance in his budget speech on March 27, 1944, that the deadline for payments of the final instalment of 1943 income taxes would be extended from April 30 to August 31 entailed a big buying boom right afterwards.

CHART VI.

Canadian, British and American Income Tax Rates Compared.



Source: Reproduced from Higgins, op.cit.,p.12.

As the Financial Post pointed out, the upsurge was noticeable in some parts of the country on the very next day.[16]

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16. The Financial Post, April 1, 1944.

Chart VI gives us a different look at the impact of income taxation upon various income groups. Taxpayers in the middle brackets (between \$5,000-\$20,000) contributed more heavily than the same group either in Great Britain or in the U.S.A. and bore the brunt of the Canadian income tax. The low brackets, the largest as to the number of taxpayers, were afforded more favorable treatment than their counterparts in Great Britain, although their tax load was well above that of the American income tax.

Different devices used during the war to alleviate the tax burden in the very low brackets, coupled with lighter rates, brought about a definite re-distribution of national income in favor of low income receivers, who somewhat intensified the pressure on the level of consumption, and it may be theoretically argued that, at the bottom, there was some room for either higher rates or a higher "minimum saving requirement".

On the whole, the Dominion income tax despite its shortcomings as to the equitable treatment of different kinds of income, as to its administration, and clarity of the Act, served Canada well during the World War II. It had been developed into a mighty fiscal instrument and a fair check against inflation. Its defects, which became too obvious, once the rates were substantially raised, were recognized by its administrators and the taxpaying public. But the chief interest was concentrated all the more on framing an equitable income tax policy for the postwar period.

The art of public finance made great strides during wartime along the lines of general economic theory. The level of government spending and taxation was recognized as one of the major factors influencing the general level of employment.

The government, fearing a postwar economic slump, began preparing for the transitory period, which among other things, included a general revision of the income tax law. The appointment of two Royal Commissions to investigate certain income tax problems were just a beginning of a thorough study of all aspects of income taxation.

Wise management of financial affairs of the country throughout the wartime period effected results which were aimed at by ministers of finance since the previous war. The federal fiscal system was rounded out by adding an inheritance tax. Perhaps the achievement was best characterized by its chief engineer, Mr. Ilsley, who in his budget speech of 1945, delivered after cessation of hostilities stated: "It is a matter for great thankfulness that we have accomplished the task and that we can now confront, in good order and in good heart, a future which is filled with problems and difficulties but also with promise."[17]

17. Debates, 1945, p. 997.

CHAPTER V.

TOWARDS A BETTER INCOME TAX LAW

During the war, and particularly thereafter, two more significant trends have influenced the development of Canadian income taxation. The first trend falls within the scope of fiscal theory, which since the appearance of Lord Keynes' famous treatise The General Theory of Employment, Interest and Money in 1936, has been greatly modified. There has been a growing understanding among economists of the uses of fiscal policy as an instrument for mitigating fluctuations in economic activity. The shadow of the possibility of a postwar economic slump made the Canadian governmental and academic economists and fiscal experts discuss plans for such an eventuality well in advance. Already during the war considerable time was spent on drawing up plans along Keynesian lines to assist in smoothing the conversion of the economy from war to peacetime conditions. Most of this planning was done on the official level in the committees of the Parliament and the Governor in Council. It resulted in the preparation of an official document, the White Paper on Employment and Income which was submitted to Parliament by the Minister of Reconstruction in April 1945, and in which the federal government committed itself to the maintenance of a stable level of employment and national income.

Such a bold commitment presupposed certain adjustments in Dominion-provincial fiscal relations, particularly in the field of direct taxation, which under the impact of war were effected

on a temporary basis. Proposals in this respect were embodied, among other things, in official publications prepared for the announced Dominion-provincial Conference on Reconstruction, where the Dominion government suggested continuance of wartime fiscal arrangements under terms more favourable to the provinces.[1] However, the provincial governments were reluctant to adopt the Dominion proposals as a whole, as the proceedings of the Conference convening in Ottawa in 1945 revealed. In the subsequent year the Conference collapsed entirely. The federal government had to revert to a piecemeal realization of its original plans, which may have served Canada better than a rapid jump into a large-scale experimenting. Furthermore, it has given more time to the federal government to perfect its chief instrument of taxation policy, the income tax, which was long overdue.

The second trend has been strictly confined to the income tax law. The structure of the Income War Tax Act remained almost unaltered after its revision in 1927. Numerous amendments, especially during the war, rendered the statute ambiguous and cumbersome, and the administration still enjoyed vast discretionary powers. The necessity of a general overhaul was clearly recognized, and as soon as the war was over the Minister of Finance announced in his budget speech in October, 1945, that

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1. The federal government offered to pay for their withdrawal from the tax fields concerned to the provinces an unconditional subsidy of not less than $12 per capita of their population in 1941 with a provision for upward revision if the national product per capita would increase.

necessary steps would be taken in order to replace the existing statute with a modernized and improved measure. Although the preparatory work was mostly done on the interdepartmental level, the public was given ample opportunity to state its views and to suggest improvements. After three years' extensive work Canada was given a new Income Tax Act, which marked a definite advance over the pre-war legislation.

Tax Rentals Agreements

After the collapse of the Conference on Reconstruction at the beginning of May, 1946, the Minister of Finance found himself in the same situation as he was in 1941. Not only was he unable to plan his budgeting for longer periods than a year but he also had to look for remedies to avoid a reversion to the pre-war chaotic situation in the income tax field. This would have been intolerable in view of the large expansion of income tax during the war. In his budget speech delivered late in June, Mr. Ilsley reviewed the history of the Conference on Reconstruction and stated the unpleasant situation resulting from the lack of accord. He told the House that the Dominion government could not stand aside and allow such a situation to develop. It would seriously impair the capacity of private enterprise to provide high and expanding employment, and it would weaken or perhaps destroy the federal system.[2] To preclude it, he announced, that he was forwarding by letter new proposals to

2. Cf. Debates, 1946, p. 2909.

the provincial premiers in respect of renewal of Dominion-provincial tax agreements on a voluntary basis.

The federal government was ready to pay annually to each agreeing province for withdrawal from the triple direct tax field (the personal income tax, corporation tax and succession duties) $15 per capita of the 1941 or 1942 provincial population in which sum was to be included a 5 per cent tax on corporation profits levied on the same basis as the Dominion corporation tax by the agreeing provinces, and collected by the Department of National Revenue. The provinces might retain the right of imposing succession duties. The federal government promised to grant a 50 per cent deduction from its levy on account of provincial tax, but the annual rental payment would be reduced accordingly.

In respect of non-agreeing provinces the Minister announced that after the expiration of the tax agreement the federal government would allow a 5 per cent reduction from personal income tax payable on account of a similar provincial levy, and the same rate on account of provincial corporate tax.

During the negotiations following the budget offer the terms of agreement were altered by Mr. Abbott, who relieved Mr. Ilsley in the portfolio of finance, and in 1947 the Dominion government entered into new tax agreements with all provincial governments save the government of Ontario and Quebec. Although both central provinces were free to levy personal and corporate taxes of their own, after the termination of the war tax agreements they imposed

only a corporate income tax of 7 per cent plus minor business taxes on various bases.[3] According to A.M. Moore and J.H. Perry these provincial levies totalled 8 1/2 per cent of corporate income, putting the over-all corporate tax liability in Ontario and Quebec 3 1/2 per cent above that in other provinces.[4] This situation continued until 1952 when the 1947 agreements expired, and a new scheme for compensating the provinces was adopted.

Under the terms of 1952-56 rental tax agreements the provincial governments were required to stop levying the additional 5 per cent corporation tax without losing the refund, and corporations residing in the only non-agreeing province of Quebec (the Province of Ontario joined the scheme late in 1952) were granted a tax allowance not more than 5 per cent[5] from the Dominion corporation tax against the taxes paid to the province. The 5 per cent tax credit for provincial personal taxes was retained, and will be in operation since the Province of Quebec has recently adopted a personal income tax.

The Dominion income tax was given a satellite in 1952 in the form of an old age security tax. The Old Age Security Act requires every person liable to income tax to pay 2 per cent of

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3. Both provinces refrained from imposing personal income taxes, but continued levying succession duties.

4. Cf. Moore, A.M. and Perry, J.H., Financing Canadian Federation, Tax Paper No. 6, Canadian Tax Foundation, Toronto, March, 1953.

5. The amending statute of 1953 granted certain corporations a 7 per cent offsetting allowance.

his taxable income but not over $60 dollars in addition to his income tax, the same rate being applied also to corporate taxpayers without the $60 ceiling.

Income Tax Reform.

The period between 1944 and 1948 may be properly described as a period of the income tax reform not only because the old Income War Tax Act was replaced by a new statute, but also because during this period there were added many significant amendments giving the tax a new meaning and a new structure. However, this is not to say that the innovations inserted into the tax law within this period were unknown to Canadian taxpayers or that they were not pressed for before. It might be recalled that the averaging of income of farmers was advocated and suggested as early as 1922, that the Dominion Association of Chartered Accountants throughout the whole period of the existence of the income tax fought the discretionary powers of the minister or that the Citizens' Research Institute recommended the carry-over and carry-back of business losses during the late twenties. However, because the federal government was not entirely sure about the future of the law, many useful propositions were passed over. We may also recall the attempt of Prime Minister Bennett in 1931 to remove the enigma of impermanence from the title of the tax law, which, taken together with many other proposals, witness the lively interest of the Canadian public and federal authorities in the income tax law, and particularly in its fair application.

The process of remodelling the Dominion income tax law began in November, 1944, by appointing the Royal Commission on the Taxation of Annuities and Family Corporations (Ives Commission) and the Royal Commission on Co-operatives (McDougall Commission). Both Commissions completed their investigations during the subsequent year and submitted reports to the Minister of Finance prior to his budget speech. However, the report of the McDougall Commission reached the Minister too late when the preparation of budget was well advanced, and consequently he postponed the decision on its recommendations until the next budget.

The budget proposals regarding the income tax announced on October 17, 1945, already bore the marks of peace-time budgeting. In response to a general demand for tax cuts, Mr. Ilsley proposed a flat 16 per cent cut in the personal income tax effective immediately (4 per cent for the whole 1945 taxation year) as well as material relief for corporations from the excess profits tax. These measures also fitted into the broad framework of the adopted compensatory fiscal policy freeing purchasing power in the hands of public and thus increasing consumption. A smaller relief was also given in the form of broadened allowance for medical expenses.

The highlights of the budget were, besides the mentioned relief, the amendments based on the Ives Commission Report. The commissioners recommended that the capital element in a contractual annuity should be exempted from the tax and only the portion

representing accruing interest should remain taxable, and that a similar method should also be used in taxing life annuities.[6] Further, they recommended that annual periodic payments under trusts and wills should be taxable to the extent only that they were paid out of income of the estate or trust.

With respect to pensions, the Commission reversed the current taxing method. It proposed that pensions should be taxable in the hands of recipients or their dependents while the payments into approved pension plans should be allowed as a tax deduction in full. Certain minor recommendations dealt with elimination of injustice in cases where previous practice departed from these principles.

The government adopted the Commission's proposals with one change, namely, a ceiling of $900 was imposed on all contributions to approved pension funds.

The method of taxing the accumulated earnings of family corporations, as proposed by the commission, was accepted save the proposal to grant 20 per cent reduction in cases of winding-up, dissolution or reorganization of the company, which was not

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6. Under the original law Dominion annuities and similar income was exempted from income tax liability by virtue of Section 3. In 1929 the Exchequer Court in the case Kennedy v. The Minister (1929, Ex. C.R. 36) impaired this provision so that the government felt necessary to counteract it. In 1930 a provision was inserted into the law exempting income from Dominion and like annuities up to $5,000. Following the decision of the Supreme Court in the Shaw case (1939, S.C.R. 338) a further amendment was adopted to tax contractual annuities according to the British practice, viz., to tax only the income element.

recommended by all three Commissioners.[7] The earnings accumulated by a private closely held company during the period 1917-39 were made tax free in the hands of its shareholders if the company paid a tax thereon according to a graduated schedule which began with an 18 per cent rate on the first $25,000 and then went upward by an additional 3 per cent for each added bracket until it reached 30 per cent on profits between $300,000 and $400,000. The profits over this limit were subject to a tax of $99,750 plus 33 per cent on the excess of $400,000. In addition, the company was allowed to pay the tax in four instalments, and it could use the privilege of election until the end of 1947.[8]

Brief reference may be made to the method adopted to reconciliate the payments under the Family Allowance Act, 1944, with deductions for dependent children under the income tax law. Every taxpayer claiming deductions for dependent children eligible for family allowance was required to pay an additional tax calculated on the basis of his marital status, taxable income, and number of dependent children. In general, a single person having an income of $800 paid 10 per cent tax on the amount of family allowance received. If he earned an income of $1,600 or over he paid a 100 per cent tax or the whole amount of family allowances. In the case of married persons the additional tax liability started at $1,200 with the 10 per cent

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7. Dr. D.A. MacGibbon abstained.

8. For details see The Royal Commission on the Taxation of Annuities and Family Corporations, Report, King's Printer, 1945, and Budget Speech, Oct. 17, 1945.

rate and progressed up to 100 per cent of the family allowances if the taxpayer had an income of $3,000 or over. Needless to say, such a method was extremely complicated, and was abandoned in the following year.

Corporate taxpayers benefited chiefly from cuts in the excess profits tax. Beginning with the date of the budget speech, corporations with profits of $5,000 or less were liable only to a flat rate of 12 per cent upon their total profits, and companies with profits over that ceiling paid 22 per cent of their total profits plus an additional 20 per cent of the excess profits in lieu of the previous 100 per cent tax. The corporation income tax rate remained unaltered.

Following the budget speech an incident occurred which spurred the Senate into setting up an investigating committee and which influenced the future fate of ministerial discretionary powers. According to Mr. Ilsley's announcement the lower rates of the personal income tax were to have an immediate effect, and employers were to begin employing a new scale of deductions at the source, as soon as the new tables were prepared. However, Mr. C. Fraser Elliott, the Deputy Minister of Taxation, made a statement on the following day that employees would have to wait for lower deductions until the end of the month of April of the next year. The incident attracted such wide publicity that the Prime Minister himself intervened, and stated in the House of Commons that the reduction would take effect immediately.[9]

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9. Cf. The Financial Post, October 20, 1945.

Shortly afterwards the Senate appointed a Special Committee to examine the provisions and workings of the Income War Tax Act and the Excess Profits Tax Act. The committee became during its sessions the most appropriate place for ventilating public criticisms of both Acts and their administration. The Committee heard briefs from various organizations ranging from the Income Taxpayers' Association to representative national bodies, like the Canadian Federation of Agriculture, labor organizations, the Canadian Manufacturers' Association, etc., which provided the senators with a good picture of Canadian public opinion on income tax matters. The expert critique came from the professional organizations of chartered accountants, of members of the bar, and other individuals qualified on tax matters.[10]

Criticism was directed to all aspects of the income tax law, but in particular to the appeal procedure then existing under the terms of Income War Tax Act. This was also reflected in the final report of the Committee which strongly recommended, among other improvements, establishment of a Board of Tax Appeals and a complete rewriting of the taxing statute.

The great bulk of new amendments were introduced and enacted during the 1946 parliamentary session, which were intended, as the Minister stated, to bring about a radical revision and

10. The Committee, particularly benefited from the briefs, or information submitted by Mr. M.L. Gordon, C. Frazer Elliott, and Mr. Ch. Oliphant from U.S. Treasury Department.

simplification of the tax and to offer an instalment in the process of rewriting and clarifying the legislation itself.[11] They affected practically every major part of the income tax statute: personal exemptions, tax rates, deductions, taxes on co-operatives, corporation tax, appeal procedure, and the discretionary powers of the Minister. Most of these amendments were applicable to 1946 and subsequent taxation years.

1. Personal exemptions were increased from $660 to $750 for single persons and from $1,200 to $1,500 for married persons. Husband and wife who both had income over the basic exemption became taxable as single persons, the previous provision granting married status to a husband and single status to his wife, if she was employed in war industry being repealed. The former allowance for dependents from the tax payable was replaced by allowances from taxable income (the prewar system). The taxpayer was permitted to abate his income by $300 for each dependent not eligible for family allowance, and $100 for each child eligible for these allowances.

2. For the first time farmers and fishermen were allowed to compute their taxable income on the basis of a three-year moving average beginning with the 1948 taxation year.

3. The complicated system of tax rates applicable to persons other than corporations and joint stock companies was replaced by one unified graduated tax rate. The initial rate was

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11. Budget Speech, June 27, 1946.

22 per cent on $250, the next rate was 25 per cent on the following $750, the next rate was 28 per cent on the additional $1,000 and so on up to 85 per cent on the excess of $250,000.[12]

4. The Minister introduced numerous minor alterations affecting mainly the tax liability of pensions received from pension trust funds, of lump-sum payments from superannuation funds and other payments received on retirement or for loss of office; tax liability of incomes received from sale of literary or similar artistic work; the method of taxation of persons residing in Canada only for a part of the taxation year; and the tax liability of members of provincial legislatures with respect to their indemnity and expense allowances.

5. The recommendations of the McDougall Commission on Co-operatives and like non-profit organizations. The Commissioners' proposals called for the abolition of the existing treatment of co-operatives under Section 4(p),[13] which - as they believed, could not survive the attacks made upon it. It

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12. See Statistical Appendix, Table E.

13. Under the original statute of 1917, cooperatives and non-profit organizations were exempted from income tax liability. In 1929 the Supreme Court held income of some cooperative marketing societies liable to tax (Fraser Valley Milk Producers' Association v. Minister of National Revenue, 1929, S.C.R. 435), and to remove the injustice in cases where it was deemed beneficial, parliament adopted Section 4(p). During the war the western wheat pools were doing a profitable business but claimed tax exemption. This situation was strongly criticized, which finally led to the appointment of McDougall Commission.

It recommended to put on the same footing all business enterprises affording privileges of patronage dividends to their customers. Accordingly, every business, whether cooperative or not, should be allowed to deduct from its taxable income the amount effectively paid to its customers in the form of a dividend. The Minister of Finance accepted this proposal in principle, but he correctly pointed out that a general application of it would introduce a rule contrary to the spirit of the tax law: namely, it would permit tax-free distribution of business profits, which the Commission itself explicitly admitted. Therefore, the government's proposal contained a limitation on the principle. No company or association would be allowed to go as far in its distribution of tax free patronage dividends as to reduce its taxable income below a reasonable return on capital employed (5 per cent) including borrowed capital less interest. To become eligible for this treatment an association or business enterprise was required either by its by-law or by a public advertisement to state well in advance its intention of granting patronage dividends.

Specific provisions were adopted in respect of allocated but not distributed patronage dividends in years subsequent to 1941, and in respect of taxing the western wheat pools on their profits made during the war.

A complete tax exemption was granted to new cooperatives for the first three years, but the law contained stiff rules defining such a co-operative in order to preclude tax evasion

by other businesses or cooperatives already established.[14] The tax free status of credit unions was enlarged as to apply also to such credit union members of which there were other cooperatives, religious, educational and non-profit organizations.

The last class of mutual organizations dealt with in the 1946 proposals were the mutual insurance companies. Beginning with January 1, 1947, the tax position of these companies was as follows: firstly, mutual fire and fire insurance companies which derived their premiums entirely from the insurance of churches, schools and other religious or welfare institutions were not subject to tax; secondly, other mutual and casualty companies were taxable with respect to their income not paid out or credited to their policyholders; thirdly, all other insurance or casualty companies carried tax liability as before; fourthly, life insurance companies, as a rule, were exempted from tax liability, but they had to pay the tax on that part of their profits which was not credited to the shareholders' account.

6. In view of an early discontinuance of the Excess Profits Tax Act, the corporation tax was materially amended as to take care of the some of the provisions of the excess profits

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14. (a) The governing law (charter, by-law, etc.,) of the coop. must offer the right to patronage dividends; (b) one member, one vote; (c) only individuals could be members and each of them could hold not more than 5% of total capital; (d) non-member business could be not over 20% of the total business per year; (e) interest or dividends on subscribed capital should not exceed 5%; (f) the business should not be a continuation of a previously established co-operative.

tax, so that since 1947 corporations and joint stock companies paid taxes chiefly under the income tax law. The corporate tax rate was raised to 30 per cent and 32 per cent in cases of non-consolidated and consolidated returns respectively, the n.o.r. investment corporations paid henceforth a 15 per cent tax rate (7 1/2 per cent reduction), and certain provisions were transferred from the excess profits tax to the income tax. They included the exemption granted to new mines coming into operation, and the exemption from the tax liability of a new class of corporations, the diversified investment corporation. To be eligible for tax exemption an investment corporation or joint stock company had to comply with Section 4(w) which provided that the capital of such a company had to be invested in securities, bonds, stocks, or held in cash to the extent of 80 per cent or more; that 95 per cent of its income had to be derived from such investments; that not more than 10 per cent of its capital was invested in securities of any one corporation or debtor save the Crown or Canadian municipality; that the number of shareholders was at least 50 or more of whom none held more than 25 per cent of the total capital stock; that the company distributed a minimum of 85 per cent of its taxable income to shareholders within 185 days after the end of the taxation year, and that it had not any outstanding securities or debentures. Minor amendments were put forward in respect of depletion, deferred maintenance and repairs and tax credit for provincial levies paid by mining and logging companies.

The excess profits tax was restricted as to apply only to corporations and joint stock companies at a 15 per cent rate on their profits in excess of 116.66 per cent of standard profits.

7. A marked departure from past practice was made in the adoption of a new appeal procedure. In accordance with the recommendations of the Special Senate Committee the government introduced provisions creating two appeal boards, the Income Tax Appeal Board and the Income Tax Advisory Board. The former has been empowered to hear and decide all questions of law under a tax assessment, whereas the latter was to advise the Minister on proper exercise of his discretionary powers. The Appeal Board has remained a permanent and convenient instance of the Canadian income tax appeal procedure. The second Board disappeared with the coming into force of the new income tax law.

The 1946 amendments of the Income War Tax Act marked, in effect, the winding-up of its development. During the next two years only minor alterations were introduced, confined more or less to the scaling down of tax rates. The chief attention of the Minister of Finance was concentrated on preparation of the new statute which was completed near the end of the 1947 session of Parliament. A revised Income Tax Bill (No. 454) was presented to the house and given first reading. This arrangement was made for the purpose of holding over the bill for the next session and to give opportunity to the members

and interested public to study the bill and suggest improvements. Many constructive suggestions were received by the Minister himself and the Standing Committee on Banking and Commerce, which brought about the necessity to redraft the bill in its entirety. This was done during the early months of 1948 and the amended Bill No. 388 was passed and put on the statute books on June 30, 1948, as Chapter 52.

Although it was contemplated to make the new Income Tax Act applicable to the 1948 taxation year, this was abandoned due to its late enactment, Instead a separate amending Act (C.53, 1948) was adopted which put into force provisions applicable to the current taxation year. They included, besides a further tax reduction, numerous minor alterations of the Income War Tax Act.

Abbott's Income Tax Act.

The Income Tax Act, being the result of four years of penetrating work, represents a marked improvement over the past, not in the basic philosophy, which was hardly affected, but in its structure, clarity of meaning, and elimination of obsolete "souvenir" provisions. The positive definition of income which was more an ornament of the old law than an effective rule, was replaced by a flexible descriptive scheme enumerating the general sources of income, deductions allowed and disallowed in computing taxable income, and the treatment of special cases in an appropriate manner. The discretionary powers of the Minister were either transferred to the Governor-

General-in-Council or converted into a rule of law. These two innovations draw perhaps the most significant dividing line between the past and present system.

As to its form, the Income Tax Act, 1948, was divided into seven Parts: Part I - Tax on Income of Residents; Part II - Tax on Income from Canada of Non-Resident Persons; Part III - Gift Tax; Part IV - Administration and Enforcement; Part V - Tax Evasion; Part VI - Interpretation; and Part VII - Transitional Provisions.

Part I and Part II comprised the main body of the tax law. In detail, it differed from previous statutes in granting an additional exemption of $500 to persons of 65 years of age, in inserting a new rate schedule ranging from 10 per cent on the first $100, up to 80 per cent on the excess over $250,000, and in new provisions affecting co-operatives, non-life insurance companies, averaging of farmers income, tax liability of non-residents, dealings between persons at arms-length, deductions for depreciation and obsolescence, appeal procedure, payment of interest on tax due, corporation tax rates, investment income exemptions, and the structure of the Tax Appeal Board. Most of these amendments were applicable to the 1948 taxation year.

The adoption of the Income Tax Act, new by name and new by its objectives has set a significant milestone in the history of the development of Canadian income taxation. It has wound up not only the era of war measures, but even more it

ended the second transforming spell of Canadian public finance. The absence of provincial income taxes and the chief reliance of the federal government upon this source of revenue indicate distinctly new lines in the future course of Canadian federalism. Mr. Abbott, in announcing the introduction of the first draft of the income tax law in his budget message, stated that the government did not consider that the measure, when enacted as law, would constitute the final word. A historian, having taken a glance on the past, stops for a while, and asks himself what will be the final word?

Despite the continuous scaling down of tax rates, the income tax has kept its prominent place among federal revenue sources. Taking the fields of income tax, excess profits and succession duties together, they contributed in the postwar period more than 50 per cent of total federal revenues. In absolute terms, the amount of collections never fell below one billion dollar mark, and, be it added, without any encroachment on the normal course of the nation's economy. During the three fiscal years, free of direct war expenditures, (1946-49), the Minister of Finance was able to retire over $1 1/2 billion of public debt and still maintain the federal expenditures at the $2 billion mark, a high level for peacetime.

A Note on Recent Developments.

There is a good rule that a historical study should not reach very far into the present lest it would lose its historical character. The issues are too fresh to be properly evaluated

in the light of the past. Therefore, we may confine ourselves to a brief review of more important developments in Canadian income taxation since the adoption of the Income Tax Act.

The Act has been revised and amended year after year, not only to adjust its impact to changing economic conditions, but also to improve its incidence. Personal exemptions were raised to $1,000 and $2,000 for single and married persons in 1949. Further increases have been resisted stubbornly. Similarly, the exemption of $2,400 or of total personal exemption in respect of investment income together with the special rate of 4 per cent on this sort of income remained unaltered. The personal and corporation rates have been changed steadily. The capitalization of undistributed profits was partially solved by Section 95A and its subsequent amendments. An attempt has been made to eliminate double taxation by granting exemption to dividend income, and to solve the problem of taxing small business by means of a progressive corporate tax rate. The problem of taxing irregular incomes, of income splitting between husband and wife, of double taxation, of reconciling business income with taxable income still attract considerable interest as the Proceedings of the recent Canadian Tax Conferences of the Canadian Tax Foundation indicate. In the administrative sphere of the income tax, a definite tendency towards decentralization may be recognized. Perhaps here, there is more room for improvement and for reducing

the costs of the taxpayer's compliance with the tax law.

Resume.

In the post-war period, there have been two currents influencing the development of federal income taxation in Canada. On the one hand the federal government has been continuously striving to avoid duplication of provincial and federal income tax, and to that end the war-time experiment of renting the provincial income tax field has been twice repeated; in 1947 and 1952 but with limited success. On the other hand, the general dissatisfaction with the income tax statute during the war brought about a complete and thorough investigation of the workings of the statute which finally resulted in the adoption of a new statute drawn upon previous experience and modern income tax standards. This process has been in continuance ever since and only lately the Income Tax Act has been again revised and consolidated. The present law, Chapter 147 of R.S.C. 1952, together with Income Tax Regulation comprise the current Canadian Income Tax Code.

CHAPTER VI.

SOME ASPECTS OF DOMINION INCOME TAXATION

On the preceding pages we have discussed the development of Dominion income taxation more or less chronologically, and from a political, economic and fiscal viewpoint. Only fragmentary reference was made to the income tax theory, and the treatment of major components of the tax was, of necessity, interrupted. It is desirable, therefore, to present in our study also a cross section of the past by tracing separately the development of some tax concepts.

Defining Income for Tax Purposes.

From the very beginning the Canadian practice has been to tax only those receipts which are effectively received, anticipated and expendable. Accordingly, such items as capital gains, gifts, and the rental value of residential property were excluded from tax liability, although they were taxed either in the United States or in Great Britain on whose systems the Canadian law was patterned.

The original Act of 1917 introduced a positive definition of income which, by and large, included only the net annual profit from property, business and employment. Subject to certain modifications we may say that this definition of income remained the most stable part of the Income War Tax Act. Perhaps we could list only two departures from this principle. Firstly, a shareholder was subject to tax on a proportionate part of

those undistributed profits of a corporation which were above a reasonable level in the opinion of the administration, though he had not received the payment. Secondly, since 1920 the income of a trust or any estate was to be calculated on the accrual basis. Other amendments added to the definition of income more or less restated or clarified the meaning of the law. For example, the addition of salaries of judges and Crown employees, and the sessional indemnities of the members of parliament effected in 1919, or redefining of the term "stock dividends" as to include capital stock dividends hardly affected the strict meaning of the definition of income.

A major departure from the original concept of income occurred only in later years. In 1935 a special tax on gifts was inserted into the income tax statute, and during World War II the Dominion adopted for the first time a succession duty. Both taxes have been levied according to their own rules and according to an entirely different schedule of rates, so that they may be regarded as complementary levies to the income tax rather than as amending features.

Inasmuch as the test of what constituted income rested in the first and last instance with the administration until 1949, it is extremely difficult to ascertain the practice followed by the Taxation Division during the past thirty years. Each case was decided on its own merits and according to the principles favored by the administration. It would therefore

be more appropriate to say that the definition of income was governed more by the ideas entertained either by Mr. Breadner, or Mr. Walters, or Mr. Elliott than by the rule of statute or decisions of the courts.

The new income tax law adopted in 1948 ended much of the uncertainty. The positive definition of income has been substituted by a definition by enumeration, that is to say, the new law puts more emphasis on itemization of receipts which are to be included or excluded from the computation of income for tax purposes.[1] However, the basic concept of income has been preserved.

From the intricate problems involved in determining income for tax purposes only one will be singled out for special reference. The divergence between the business income and taxable income, which was of much concern in business circles prior to the adoption of the present law, largely disappeared after the end of the last war.[2] More attention has been concentrated on the problem of capital gains.

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1. Section 3 merely states that "the income of a taxpayer for a taxation year...is his income for that year from all sources inside and outside Canada, and without restricting the generality of the foregoing, it includes income for the year from all(a) business, (b) property, and (c) office and employment.

2. Only recently Mr. A.K. Eaton, Assistant Deputy to the Minister of Finance stated that "the most striking fact that emerges to me in comparison of the business income concept with that of taxable income is the very close correspondence between the two. By and large, year in and year out, for most firms they pretty much coincide". -Business Income ahd Taxable Income, an address delivered at the Seventh Annual Tax Conference of the Canadian Tax Foundation, Report of Proceedings, Winnipeg, Nov. 23-24, 1953, p. 21.

Here we may refer to two specific controversies.

In dealing with borderline cases the courts apply "intention" as the principal test in deciding whether a receipt in question is of an income or capital nature. In very rough terms it means that a gain arising from the sale of property would be treated as a capital gain whenever the taxpayer can prove his intention of holding the property for investment purposes. To what extent this yardstick coincides with the economist's concept of capital gain, must be left to the lawyers. Keynes, Hicks and Seltzer considered expectation as the main criterion for distinguishing between income and capital gain. In Seltzer's words "an expected rise in the price of any asset is ordinary income; an unexpected rise, a capital gain".[3]

The second development was incepted by a remarkable statement of Mr. Perry at the Sixth Annual Tax Conference in 1952. "A corporation", he stated, "by definition, cannot make a capital gain; that its very nature is such that every transaction that it enters into produces income."[4] Similar principles are well established and sanctioned by the law in European countries having the commercial law based on German commercial law. There might be some doubts raised, however,

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3. Seltzer, L.H., The Nature and Tax Treatment of Capital Gains and Losses, New York, 1951, p. 47.

4. Perry, J.H., Identifying Income, Report of Proceedings, Sixth Annual Tax Conference of Canadian Tax Foundation, Montreal, Nov. 3-4, 1952, p. 32.

in cases when a corporation disposes of its capital assets. Incidentally, the Supreme Court of Canada in the Sutton Lumber & Trading Co. Ltd. case decided recently in favor of the corporate taxpayer, declaring profits made on sale of timber limits as capital gains.

In respect of differentiation among various kinds of income, the Canadian practice employed for the first seventeen years only one specific rule. It taxed the income in kind of farmers who were required to include in the net income the value of goods produced and consumed on the farm. Surprisingly, the rental value of residential property which by its nature is of similar character was never subjected to tax. In 1935 the discrimination against investment income was introduced and to that was added during the war special treatment of irregular income. In fact, we may say, that according to the present Canadian law almost every kind of taxable income is afforded some kind of averaging. Farmers and fishermen are allowed to average their income over a period of five years, while business losses may be carried over and back within seven years. If we look at the method of stoppage at source as a splitting of the tax over smaller periods, we may say that the taxpayer is allowed to average his income over a period of one year. The averaging of incomes, although seemingly one of the better ways of spreading the tax burden more equally among various groups of taxpayers has serious disadvantages. It contradicts the principle of

simplicity and extends the taxation period, which in turn impairs control, and it returns the system to the old principle of taxating historical income.[5]

We have to pass over various other forms of income which, being of a quasi-rent nature, are not included in the definition of income, and merely attract the interest of some writers.

Traditionally, the Canadian concept of income has remained in between the American and British concepts. the exemption of capital gains from taxation, in principle at least, distinguishes the Canadian concept from that employed in the United States. On the other side, in contrast with the British concept it includes the corporate income as a separate tax base. The same inference may be made on its relation to the better known economic definitions of income. The Canadian practice has adhered to none of the economic definitions, and, in our opinion, this method has its own merits. The economic definition of income should be broader in scope, for the economics deals with every phase of economic activity. The taxable

5. John Willis suggested considerable extension of the averaging principle for various fluctuating and irregular incomes. As a principle, we favor much more granting relief in the form of lower rates rather than in the form of spreading the income over years. The gradual refinements of the method of computation of the tax liability are getting too complicated, and may lead to the defeat of the whole system. For detailed treatment of various averaging methods see Willis John, The Mitigation of the Tax Penalty on Fluctuating or Irregular Incomes, Canadian Tax Papers, No. 2, Canadian Tax Foundation, Toronto, September, 1951.

concept of income is strictly a matter of practice and above all of expediency.

Tax Rates and Exemptions.[6]

During the past 36 years the Canadian administration tried practically all forms and methods of tax rates and personal exemptions. To a certain degree, the changes in both reflected the economic situation of the country. When the times were good tax rates and exemptions remained relatively stable, and again in trying years they were changed almost from year to year. To be sure, since the inauguration of the compensatory fiscal policy tax rates have been continuously adapted to over-all government's economic policy. Perhaps there is no need to emphasize the close relationship between tax rates and the definition of income. Under low rates the definition of income plays but a minor role, and it does not matter much whether the concept of income relates to gross or net income. However, once the rates represent a sizeable part of one's income complaints, litigation, evasion and all sorts of difficulties begin mushrooming.

Apart from the original law of 1917, continuous practice in Canada employed four factors in determination of the progressive tax liability: family status, number and age of persons

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6. This section should be read in connection with Tables E,F, and G of the Statistical Appendix.

dependent on the income, the volume of income, and the nature of income. Whereas the first two factors determined the zero tax rate, the latter two conditioned its progressivity.

The Act of 1917 established the upper limit of personal exemptions for single and married persons, namely, $1,500 and $3,000. However, these exemptions were in the subsequent year replaced by a lower set of $1,000 and $2,000 which remained unaltered until the amendments adopted in 1926. The allowance for dependents introduced into the law in 1918 was originally applicable only to dependent children. It amounted to $200 for each child under 16 years of age, but this limit was gradually raised and the applicability extended as to apply to dependent children regardless of age if they were incapable of self-support due to mental or bodily defects. During the early twenties this allowance was gradually raised to $400 and $500.

Sir Thomas White inaugurated in his first law a composite structure of tax rates, namely, a flat rate called "normal tax" and a graduated tax called "surtax". The latter rate was mildly progressive ranging from two per cent to 25 per cent.The tax rate introduced in 1918 and applicable to the second taxation year included three different levies: a normal tax, a supertax graduated from 2 per cent to 50 per cent by successive brackets, and a surtax also graduated but computed as a percentage of the two former levies. In 1919 the

rates were simplified and increased. The normal rate went up (4% and 8%) and the graduated tax ran from 1% up to 65% on income brackets ranging from $1,000 to $1,000,000. This structure remained in force until 1926 with an additional 5% of the total tax imposed since the 1919 taxation year.

Mr. Dunning revamped the structure of personal exemptions and tax rates in 1926 (effective for 1925 taxation year). The personal exemptions moved upward to $1,500 and $3,000. The new law imposed only one graduated tax (2% - 50%) on the same cumulative principle as before, but the brackets were somewhat narrowed. The next two years brought successive cuts in the schedules so that in 1928 the effective graduated tax ran from 1.6% to 40% for the same brackets.

Mr. Bennett's proposals in 1931 for a simplified tax structure were later called off, and it may suffice to mention that they included a graduated tax (1% - 25%) on incomes between $1,000 and $24,000. If effected it would have meant a clear departure from the established system of bracketing the whole tax base. Mr. Bennett's successor as Minister of Finance established the present system of tax rates. It includes a dollar rate for the amount below the bracket and a percentage rate for the particular bracket. The advantage of this tabulation is obvious. Under the previous method the taxpayer in the highest bracket had to run through the whole tax schedule to figure out his tax liability. Under this system he simply adds to the dollar rate the necessary percentage

on the remainder in whichever bracket it falls.

During the depression fiscal necessities brought about further adjustments in personal exemptions and tax rates. In 1932 exemptions were lowered to $1,200 and $2,400 and tax rates were increased by 25 per cent, inclusive of the relief granted in 1927 and 1928. The budget of 1933 brought further downward adjustments. It set the personal exemptions at $1,000 and $2,000, the dependent allowance at $400, and the new rate schedule ran from 2 per cent on the first $2,000 up to 56 per cent on the bracket over $500,000 plus additional 5 per cent thereof. This arrangement continued in force until the beginning of World War II.

War conditions necessitated drastic changes. The first war years saw a gradual downward readjustment in personal exemptions so that in 1942 only one flat exemption of $60 was allowed for each taxpayer irrespective of his status. The allowance for dependents ($80) was transformed into abatements from the tax and included a new deduction of $150 on account of marital status.

The previous two taxes on taxable income (national defence and income tax) which employed separate sets of exemptions and tax rates were unified into one levy consisting of a normal tax and graduated tax. The normal tax was moderately graduated (7%-9%) in case of single persons but married persons paid only a 7 per cent flat rate. The graduated tax ranged from 30 per cent on the first $500 and moved steeply upward up to 85 per

cent on incomes in excess of $100,000. From the total tax liability the taxpayer was credited with a certain amount, called the saving portion (maximum $800, $1,000 and $100 for single, married persons and dependents respectively), which became repayable in the postwar years.

When the war ended the administration reintroduced the old scheme of tax exemptions and tax rates. Personal exemptions were fixed in 1946 at $750 and $1,500 for single and married persons, the allowance for dependents represented an amount of $100 for children eligible for family allowance (first introduced in 1945) or $300 for all other dependents. Finally, in 1948 they were raised to the present level, viz., $1,000 and $2,000 for single and married persons, and $150 and $400 for children eligible for family allowances and other dependents.

The Dominion income tax law has afforded since its inception a special treatment to investment income in different forms. In the early years dividends were exempted from normal tax, being subject to supertax only. In 1926 the government deliberately introduced double taxation of corporate incomes, for under the system then adopted the dividends would otherwise have escaped tax entirely. The second break came in 1935 when the discrimination against investment income was enacted. Since then unearned income has been subject to an additional levy governed by separate rules in respect of exemptions and rates. Firstly, investment income up to $5,000, or the whole of personal

exemptions, was exempt, but earned income over $14,000 was treated as investment income. Secondly, rates applicable to investment income over the basic exemption moved upward on a mildly graduated scale (2% to 10%) according to income brackets. To be sure, this levy was further increased by the 5 per cent additional levy, and by the normal tax applicable to all incomes.

This scheme of taxing investment income remained in force until 1941, when because of material increases in the general income tax, only one flat rax rate was imposed (4%) on investment income in excess of $1,500. While the rate has contained in force up to the present time, the basic exemption was often altered. In the subsequent year it was cut to $1,200, and since then by gradual increases, it has reached the present level of $2,400. To be sure, the privilege of using the total of personal exemptions, if higher, was also reintroduced after the war.

The income of non-residents originating in Canada was leaving the country tax free until 1935. In that year a flat rate of 5 per cent was levied on all interest and dividends (interest on bonds issued or guaranteed by the Dominion government or issued by provincial governments was exempt) paid by Canadian debtors to foreign creditors. During the war this rate was raised to 15 per cent subject to certain specifications, and in the course of the postwar amendments it was differentiated so that at the present time it varies from 5 per cent to 15 per

cent depending on the nature of the payment.

The developments in the corporation tax will be reviewed but briefly here. The early practice was to grant a basic exemption to corporate taxpayers which for the most years represented an amount of $2,000. It was discontinued in 1933 but corporations were permitted to file consolidated returns at a slightly higher rate. The tax rates moved gradually upward from a low 4 per cent rate introduced in 1917 up to 20 per cent on income not over $10,000 and 50 per cent on the excess now in force. The differential rate for consolidated returns rose from 1/2 per cent to 2 per cent during the thirties and became a rule until 1952 when the privilege of filing consolidated returns was withdrawn.

To sum up our remarks, it may be pointed out that the federal authorities employed chiefly "double-decker" schemes of income tax rates in respect of personal incomes. It was either in the form of a normal tax and graduated tax or in the form of a graduated tax and additional tax. From the inception of income discrimination up to the postwar period a supplementary tax on investment income was levied, so that the taxpayers having investment income was subject to a triple levy. But in the postwar period the administration has stuck to a single graduated levy on earned incomes and a flat tax on the unearned incomes. As a rule the exemptions varied according to the levies employed. Very seldom have the same set of

exemptions applied to the zero point of all rates.

The selection of graduation curves depended entirely upon political considerations in the earlier period. They followed a rather mild upward trend, not transgressing the 50 per cent ceiling. In war time the graduation trend moved steeply upward, but recent rates adopted considerably modified the progressivity of the tax. However, the author was not able to ascertain if, and to what extent, the Department of Finance employs mathematical formulas in selecting tax rates,[7] or if they subscribe to Dr. Vickrey's opinion that "it cannot be pretended that the exact adherence to any such formula is of vital importance, however. The special properties of the formula, while interesting, carry only the most tenuous evidence of any relation to general welfare."[8]

Administration of the Income Tax.

The income tax was put originally under the administrative responsibility of the Minister of Finance who administered all special war taxes introduced during World War I. In 1918 a special division of taxation was established within the

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7. To the author's knowledge only the Italian income tax employs a mathematical formula for devising the tax rates. It is based on Pareto's form of income distribution ($x=aN^k$), and runs as follows:

$$Y = 0.04186X^{0.39367}$$

where Y is the amount of the tax, and X is the taxable income. (Cf. Neumark, F. Theorie and Praxis der Modernen Einkommenbesteurerung, Bern, 1947, p. 391.)

8. Vickrey, W., Agenda for Progressive Taxation, New York, 1947, p. 376.

ministry to administer both the income tax and excess profits tax, and the former head of the Department of Customs, Mr. Breadner, was put in charge of it. The tax remained within the jurisdiction of the Minister of Finance until 1924, when it was transferred to the Department of Customs and Excise, which three years later was thoroughly reorgnized and received the present name of the Department of National Revenue. The permanent head of the division bore the title of The Commissioner of Income Tax until 1943 when he assumed the present name of the Deputy Minister of National Revenue for Taxation.

Prior to the last war the Taxation Division was of far lesser significance than it is today. It employed about 1,200 employees in 1937, who at that time were entirely outside the authority of the Civil Service Commission. However, during the war and in the postwar period the Division augmented its number of employees and after the reorganization of 1946 its staff was put under the same rules as other civil servants.

The first Income War Tax Act inaugurated the principle of stoppage-at-source similar to that used in Great Britain, but in the subsequent year this was abandoned and replaced by information-at-the-source method. The assessment was done by the Head Office in Ottawa during the first three years, which, of course, protracted the assessment procedure and impaired the collection of the tax. In 1920 the whole system was overhauled due to the introduction of the principle of self-assessment. The taxpayer was required to compute his

tax liability and to pay the tax accordingly, thus relieving the tax administration from much clerical work which could concentrate more on checking the returns. However, the assessment became closed only by issuance of the assessment notice by the Taxation Division. The method of self-assessment was further strengthened by putting the collection of the tax on an almost complete pay-as-you-earn basis in 1942. Both methods have remained permanent and outstanding features of Canadian tax administration, and it must be admitted that in this respect Canada is far ahead.

The edge of criticism and dissatisfaction with the former Income War Tax Act was directed chiefly against the wide discretionary powers of the Minister and his Deputy, and against the lack of proper legal remedies. Indeed, the wide ministerial powers under a system of centralized administration tend to cause hardship to the taxpayer. In a way, they presuppose the infallibility of the officer exercising them. Many of the complaints would have been removed, had the early administration established an appeal procedure within its framework. This would have called for a wide decentralization of the whole assessment procedure, even on a larger scale than in the present system. As we see the problem, the basic principle of either judicial or administrative process is that the affected party must have a legal remedy against the final decision handed down in the first instance. Under the Income War Tax Act it would have been quite simple to have established

the District Taxation Office as a court of first instance by vesting all necessary powers in the head of the office. Then the Taxation Division could perform the functions of an appellate administrative court.[9]

Prior to the establishment of the Appeal Board the taxpayer, if dissatisfied with the assessment, could file a notice of appeal with the minister upon which the assessment was reviewed and either affirmed or altered. Only then was the taxpayer free to appeal the assessment to the Exchequer Court. The costs of appeal were so high that they deterred many taxpayers from having recourse to this legal remedy, particularly if the assessment was below $400. The position of the taxpayer was also worsened by deliberate refraining of the Taxation Division from publishing its rulings on matters subject to ministerial discretion. The taxpayer simply did not have any reliable guide when he figured out his tax liability as to what position the tax administration would take in a particular case of his concern. At least one explanation of this peculiar policy was recorded by Dr. Petrie in his doctoral thesis. "It has been the policy", he wrote,

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9. This is the established administrative procedure adopted in European countries. The local taxation offices perform all duties, which are here in Canada divided between the head office and the District Office. The taxpayer is allowed to appeal the assessment firstly to the Ministry of Finance and then to the Supreme Court for administrative cases.

"to avoid as much as possible formal regulations that might be binding. The obvious danger of such procedure is that an inefficient or corrupt administration could use the wrong kind of discretion, with disastrous results to the equity of assessment."[10] The storm of protests presented to the Special Senate Committee in 1946 in this respect seem to indicate that the taxpaying public disagreed with the official practice.

Since 1946 many of the administrative defects have been eliminated. Firstly, the Appeal Board was instituted to hear appeals on the first instance. Secondly, an Advisory Board was added to the Taxation Division to advise the Minister on exercising the discretionary powers, which, of course, disappeared after the present law was put into force. The necessary flexibility of the law is assured by powers vested in the Governor-in-Council to regulate certain matters whose decisions are made public. Furthermore, there is a definite tendency towards decentralization. Under Part IX of the Income Tax Regulations[11] the Director of Taxation in a District Office is empowered to exercise certain powers vested by the law in the Minister of National Revenue. As a rule, the assessment procedure is completed in the District Office, since only special cases go to Ottawa. The taxpayer, if

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10. Petrie, J.R., The Tax Systems in Canada, McGill University, 1940, a doctoral thesis, (not published), p. 1073.

11. Order in Council, P.C. 6471, December, 1949, as amended by Order in Council P.C. 4443, August 29, 1951.

dissatisfied with the assessment may appeal to the Appeal Board, then to the Exchequer Court, and finally to the Supreme Court.

Conclusion.

The history of the federal income tax in Canada transgresses the narrow limits of a financial history. The tax has been in turn a political programme, a constitutional issue, and only recently has it assumed great importance in the fiscal and economic affairs of the country. Hardly any other institution reflects more closely the spectacular growth of Canada's economy and its changing social environment during the past fifty years.

On the morrow of this century the income tax issue gradually evolved into a major driving force of the agrarian movement, which in a sense heralded a new partner in the federation, namely, the agricultural west. As we have seen, it was the two younger prairie provinces of Saskatchewan and Alberta where the tax found the most staunch supporters. This, together with other factors, laid foundations for the two distinctive political philosophies prevailing at present in both provinces.

After its introduction into the federal revenue system during World War I, the income tax was predestined to influence further the evolution of the Dominion federal structure. The twenties and thirties witnessed a lively debate on the constitutional division of taxation rights between the Dominion and the provinces, and finally led to a searching investigation of the whole problem. Here again the income tax was given

prominence, for the core of the recommendations of the Rowell-Sirois Commission pertained to direct taxation. Although the proposals of the Commission elicited a strong opposition of the original partners of the federal contract, the course of events necessitated at least an ad hoc solution in the form of tax rental agreements.

During this fermenting period the income tax did not play any significant role in the Dominion finances. Its fiscal yield did not amount to much in terms of dollars collected, and was surpassed by other revenues derived from standard indirect taxes. This picture was radically changed during the past war, when for the first time the income tax was called upon to do its full share in financing the war. Its impressive service is still fresh in the memory of Canadians, and need not be emphasized.

Looking back into the past and comparing it with the present, it must be admitted that the income tax has represented a major factor in Canada's development. It helped to balance the country's political institutions; it taught Canadian businessmen to economize and to calculate; and in the present time it gives everyone a fairer proportion from the nation's cake, and thus a greater feeling of security. And in doing so, the tax helps to bring closer to reality the dreams and visions of the founding fathers.

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STATISTICAL APPENDIX

TABLE A

TOTAL FEDERAL REVENUES, EXPENDITURES, AND NET DEBT, 1914 - 1952.

($ 000,000)

Fiscal Year Mar.31	Total Tax Revenue	Total Revenue	Total Expenditures	Budget Surplus -Deficit	Net Debt
1914	126	163	186	- 23	336
1915	98	133	248	- 115	449
1916	125	172	340	- 168	615
1917	175	233	498	- 266	879
1918	197	261	577	- 316	1,191
1919	224	313	697	- 384	1,575
1920	294	350	786	- 436	2,249
1921	369	436	528	- 92	2,341
1922	320	382	464	- 81	2,422
1923	335	403	434	- 31	2,454
1924	342	407	371	36	2,418
1925	294	352	351	-	2,417
1926	328	382	355	28	2,390
1927	347	400	359	42	2,348
1928	365	429	379	51	2,296
1929	396	460	389	71	2,226
1930	379	453	405	48	2,177
1931	296	357	442	- 84	2,262
1932	275	335	449	- 114	2,375
1933	254	311	533	- 221	2,596
1934	271	325	458	- 133	2,730
1935	304	362	478	- 116	2,846
1936	317	373	533	- 160	3,006
1937	386	454	532	- 77	3,084
1938	448	516	534	- 18	3,102
1939	435	502	553	- 51	3,153
1940	468	562	680	- 119	3,271
1941	778	872	1,250	- 377	3,648
1942	1,361	1,489	1,885	- 397	4,045
1943	2,067	2,249	4,387	- 2,138	6,182
1944	2,437	2,765	5,322	- 2,557	8,740
1945	2,155	2,687	5,246	- 2,558	11,298
1946	2,202	3,013	5,136	- 2,123	13,421
1947	2,428	3,007	2,634	374	13,047
1948	2,452	2,872	2,196	676	12,371
1949	2,436	2,771	2,176	595	11,776
1950	2,323	2,580	2,449	132	11,645
1951	2,785	3,113	2,901	211	11,433
1952	3,658	3,940	3,733	248	11,185

Source : The Canada Year Book, 1951; Public Accounts of Canada, 1953.

TABLE B .

GENERAL STATISTICS - NUMBER OF TAXPAYERS AND INCOME TAX PAID FOR FISCAL YEARS 1919 - 1950.

Fiscal Year Mar.31	Individuals No. of Taxpayers	Individuals Tax Paid	Corporations No. of Taxpayers	Corporations Tax Paid
	000	$ 000,000	000	$ 000,000
1919[a]	15	7.9	1.6	1.4
1920[a]	92	13.1	2.2	7.-
1921	191	32.-	3.7	13.8
1922	291	39.8	8.2	38.9
1923	281	31.6	6.-	28.-
1924	239	25.6	5.5	28.5
1925	226	25.1	6.2	31.-
1926	210	23.8	5.7	31.7
1927	116	18.-	5.7	29.3
1928	122	23.2	6.1	33.3
1929	130	24.8	7.4	34.6
1930	142	27.2	7.9	41.8
1931	144	26.6	7.6	44.4
1932	134	24.8	6.-	36.4
1933	167	25.9	6.5	36.1
1934	203	29.2	8.9	27.4
1935	184	25.2	10.4	35.8
1936	199	33.-	10.9	42.5
1937	217	35.4	12.1	58.-
1938	237	40.4	13.9	69.8
1939	265	46.9	13.8	85.1
1940[b]	300	45.4	17.6	77.9
1941[b]	871	104.-	15.9	131.6
1942	1,781	296.-	9.1	165.8
1943[c]	2,163	534.-	9.9	348.-
1944[c]	2,254	813.-	20.-	311.4
1945	2,254	768.-	21.3	276.4
1946	2,353	692.-	23.6	217.8
1947	2,366	695.-	27.2	196.8
1948	2,689	763.-	28	351.5
1949	2,231	622.-	28.6	488.5
1950	2,374	652.-	31.2	602.-

Source: D.B.S. Incomes Assessed for Income War Tax in Canada,1933-38. The Canada Year Book. Department of National Revenue (Taxation Division) Taxation Statistics.

a. Statistics taken from D.B.S. Income Assessed for I.W.T.A.

b. Statistics for years 1921-40 taken from The Canada Year Book, and for years 1941-50 from Taxation Statistics.

c. Taxation Statistics.

TABLE C

COLLECTIONS UNDER THE INCOME TAX ACT, 1919 - 1952.

(For Fiscal Years Ended March 31)

($ 000,000)

Year	Individuals	Corporations	Tax on Undistributed Income	Non-Resident Tax	Total Income Tax
	$	$	$	$	$
1919	8	1			9
1920	13	7			20
1921	33	14			46
1922	40	39			79
1923	32	28			60
1924	26	29			54
1925	25	31			56
1926	23	32			56
1927	18	29			47
1928	23	33			57
1929	25	34			59
1930	27	42			69
1931	27	44			71
1932	25	36			61
1933	26	36			62
1934	29	27		5	61
1935	25	36		6	67
1936	33	42		7	83
1937	35	58		9	102
1938	40	70		10	120
1939	47	85		10	142
1940	45	78		11	134
1941	104	132		13	248
1942	296	186		28	510
1943	534	348		28	910
1944	813	311		27	1,152
1945	768	276		29	1,673
1946	691	218		28	938
1947	695	197	42	30	963
1948	660	352	13	36	1,060
1949	763	489	3	43	1,298
1950	622	602	1	47	1,273
1951	652	712	88	62	1,513
1952	776	1,118	15	55	2,163

Source : Department of National Revenue (Taxation Division) Taxation Statistics, 1952.

TABLE D

TOTAL ANNUAL COLLECTIONS UNDER THE INCOME TAX ACT, THE EXCESS PROFITS TAX ACT, AND SUCCESSION DUTIES ACT; COST OF COLLECTIONS, 1917 - 1952

($ 000,000)

Fiscal Year Mar.31	Total Annual Collections	Total Annual Cost	Percentage Cost of Collections
	$	$	%
1917	13	0.058	0.46
1918	21	0.1	0.51
1919	42	0.5	1.17
1920	64	1.1	1.78
1921	87	2.0	2.24
1922	102	2.3	2.24
1923	73	2.0	2.80
1924	59	1.9	3.28
1925	59	1.7	2.87
1926	57	1.7	3.04
1927	48	1.7	3.58
1928	58	1.9	3.39
1929	60	2.1	3.55
1930	69	2.1	3.10
1931	71	2.1	3.03
1932	61	2.1	3.48
1933	62	2.0	3.16
1934	61	1.9	3.12
1935	67	2.0	2.95
1936	83	2.1	2.56
1937	102	2.1	2.08
1938	120	2.3	1.87
1939	142	2.4	1.70
1940	134	2.5	1.85
1941	272	2.9	1.06
1942	652	3.8	0.59
1943	1,378	5.4	0.39
1944	1,635	8.0	0.49
1945	1,556	9.9	0.64
1946	1,453	11.8	0.81
1947	1,435	13.7	0.96
1948	1,318	19.6	1.49
1949	1,368	28.0	2.05
1950	1,301	28.1	2.16
1951	1,557	25.1	1.62
1952	2,204	21.9	0.99

Source : Department of National Revenue (Taxation Division) Taxation Statistics, 1952, Table B.

TABLE E - I

INDIVIDUAL GRADUATED RATES, 1917 - 1952 [d]

(Taxation Years 1917 - 1924).

Brackets: Taxable Income over	not over	Taxation Years 1917	1918 [a]	1919	1920 [b]
$ 000	$ 000	%	%	%	%
6	8	2	2.1	2	2.1
8	10	2	2.1	3	3.15
10	12	5	5.5	4	4.2
12	14	5	5.5	5	5.25
14	16	5	5.5	6	6.3
16	18	5	5.5	7	7.35
18	20	5	5.5	8	8.4
20	22	8	8.8	9	9.45
22	24	8	8.8	10	10.5
24	26	8	8.8	11	11.55
26	28	8	8.8	12	12.6
28	30	8	8.8	13	13.65
30	32	10	11.-	14	14.7
32	34	10	11.-	15	15.75
34	36	10	11.-	16	16.8
36	38	10	11.-	17	17.85
38	40	10	11.-	18	18.9
40	42	10	11.-	19	19.95
42	44	10	11.-	20	21.-
44	46	10	11.-	21	22.05
46	48	10	11.-	22	23.10
48	50	10	11.-	23	24.15
50	52	15	16.5	24	25.2
52	54	15	16.5	25	26.25
54	56	15	16.5	26	27.3
56	58	15	16.5	27	28.35
58	60	15	16.5	28	29.4
60	62	15	16.5	29	30.45
62	64	15	16.5	30	31.5
64	66	15	16.5	31	32.55
66	68	15	16.5	32	33.6
68	70	15	16.5	33	34.65
70	72	15	16.5	34	35.7
72	74 [c]	15	16.5	35	36.75
74 [c]	76	15	22.-	36	37.8
76	78	15	22.-	37	38.85
78	80	15	22.-	38	39.9
80	82	15	22.-	39	40.95
82	84	15	22.-	40	42.-
84	86	15	22.-	41	43.05
86	88	15	22.-	42	44.1
88	90	15	22.-	43	45.15

TABLE E - 1 (Continued)

INDIVIDUAL GRADUATED RATES, 1917 - 1952.

(Taxation Years 1917 - 1924).

Brackets: Taxable Income over	not over	Taxation Years 1917	1918	1919	1920
$ 000	$ 000	%	%	%	%
90	92	15	22.-	44	46.2
92	94	15	22.-	45	47.25
94	96	15	22.-	46	48.3
96	98	15	22.-	47	49.35
98	100	15	22.-	48	50.4
100	150	25	28.75	52	54.6
150	200	25	28.75	56	58.8
200	300	25	40.5	60	63.-
300	400	25	40.5	63	66.15
400	500	25	47.25	63	66.15
500	600	25	47.25	64	67.6
600	800	25	54.-	64	67.2
800	1,000	25	61.75	64	67.2
1,000		25	67.5	65	68.25

a. Inclusive surtax imposed as follows:

$ 6,000 -	$ 10,000	5%
10,000 -	100,000	10%
100,000 -	200,000	15%
200,000 -		35%

b. 5% surtax inclusive. (Enacted in 1920).

c. Read "75" for the column "1918".

d. Source: The Income War Tax Act, 1917, and subsequent amending Acts. The Income Tax Act, 1948, and subsequent amending Acts. (See Table K).

TABLE E - 2

INDIVIDUAL GRADUATED RATES, 1917 - 1952.
(Taxation Years 1925 - 1931).

Brackets: Taxable Income over $ 000	not over $ 000	Taxation Years 1926 %	1927 %	1928 %	1932 %
	2	2	1.8	1.6	2.1
2	3	3	2.7	2.4	3.15
3	4	4	3.6	3.2	4.2
4	5	5	4.5	4.-	5.25
5	6	6	5.4	4.8	6.3
6	7	7	6.3	5.6	7.35
7	8	8	7.2	6.4	8.4
8	9	9	8.1	7.2	9.45
9	10	10	9.-	8.-	10.5
10	11	11	9.9	8.8	11.55
11	12	12	10.8	9.6	12.6
12	13	13	11.7	10.4	13.65
13	14	14	12.6	11.2	14.7
14	15	15	13.5	12.-	15.75
15	16	16	14.4	12.8	16.8
16	17	17	15.3	13.6	17.85
17	18	18	16.2	14.4	18.9
18	19	19	17.1	15.2	19.95
19	20	20	18.-	16.-	21
20	25	21	18.9	16.8	22.05
25	30	22	19.8	17.6	23.1
30	35	23	20.7	18.4	24.15
35	40	24	21.6	19.2	25.2
40	45	25	22.5	20.-	26.25
45	50	26	23.4	20.8	27.3
50	55	27	24.3	21.6	28.35
55	60	28	25.2	22.4	29.4
60	65	29	26.1	23.2	30.45
65	70	30	27.-	24.-	31.5
70	75	31	27.9	24.8	32.55
75	80	32	28.8	25.6	33.6
80	85	33	29.7	26.4	34.65
85	90	34	30.6	27.2	35.70
90	95	35	31.5	28.-	36.75
95	100	36	32.4	28.8	37.8
100	110	37	33.3	29.6	38.85
110	120	38	34.2	30.4	39.9
120	130	39	35.1	31.2	40.95
130	140	40	36.-	32.-	42.-
140	150	41	36.9	32.8	42.05
150	175	42	37.8	33.6	44.1
175	200	43	38.7	34.4	45.15
200	250	44	39.6	35.2	46.2
250	300	45	40.5	36.-	47.25
300	350	46	41.4	36.8	48.3
350	400	47	42.3	37.6	49.35
400	450	48	43.2	38.4	50.4
450	500	49	44.1	39.2	41.45
500	-	50	45	40	52.5

TABLE E - 3

INDIVIDUAL GRADUATED RATES, 1917 - 1952.

(Taxation years 1932 - 1941)

Brackets: Taxable Income over	not over	Taxation Years 1932-39[a]	1940	1941
$ 000	$ 000	%	%	%
-	.250	-	6	15
.250	1	3	8	15
1	2	4	12	20
2	3	5	16	25
3	4	6	20	30
4	5	7	24	33
5	6	8	27	36
6	7	9	30	38
7	8	10	33	40
8	9	11	35	42
9	10	12	37	44
10	11	13	39	47
11	12	14	39	47
12	13	15	39	47
13	14	16	39	47
14	15	17	39	47
15	16	18	39	50
16	17	19	39	50
17	18	20	39	50
18	19	21	39	50
19	20	22	39	50
20	25	23	41	53
25	30	24	41	53
30	35	25	44	55
35	40	26	44	55
40	45	27	47	57
45	50	28	47	57
50	55	29	50	59
55	60	30	50	59
60	65	31	50	59
65	70	32	50	59
70	75	33	50	59
75	80	34	53	63
80	85	35	53	63
85	90	36	53	63
90	95	37	53	63
95	100	38	53	63
100	110	39	56	67
110	120	40	56	67
120	130	41	56	67
130	140	42	56	67
140	150	43	56	67

TABLE E - 3 (Continued)

INDIVIDUAL GRADUATED RATES, 1917 - 1952.

(Taxation Years 1932 - 1941)

Brackets: Taxable Income over	not over	Taxation Year 1932-39 a	1940	1941
$ 000	$ 000	%	%	%
150	175	44	59	70
175	200	45	59	70
200	225	46	63	75
225	250	47	63	75
250	275	48	63	75
275	300	49	63	75
300	325	50	67	80
325	350	51	67	80
350	375	52	67	80
375	400	53	67	80
400	450	54	72	80
450	500	55	72	80
500	-	56	78	85

a. Plus 5% of the amount of tax on incomes exceeding $ 5,000. The first war budget of 1939 added 20% of the amount of tax on all incomes.

TABLE E - 4

INDIVIDUAL GRADUATED RATES 1917 - 1952.
(Taxation Years 1942 - 1946)

Brackets: Taxable Income over	not over	Tax Rate[a]
$ 000	$ 000	%
-	0.5	30
0.5	1	33
1	2	37
2	3	41
3	5	45
5	8	50
8	13	55
13	20	60
20	30	65
30	50	70
50	70	75
70	100	80
100		85

a. The tax rate represented a gross tax liability. The net tax was equal to the gross tax less the following items:

1. <u>Abatements from the tax:</u>

   i. $150 for dependent wife;
   ii. 80 for each person wholly dependent;
   iii. 20% of the amount expended for support of a partial dependent, but not over $400.

11. <u>Savings Portion</u> (refundable at a later date):

"Single Person"

i. Half the total taxpayable; or
ii. 8% of taxable income plus 1% for each dependent; or
iii. $800 plus $100 for each dependent.

"Married Person"

i. Half the total tax payable; or
ii. 10% of taxable income plus 1% for each dependent; or
iii. $1,000 plus $100 for each dependent.

111. <u>Subsequent Tax Adjustments:</u>

For 1942 taxation year 50% of the total tax payable; for 1945 taxation year 4% and for the 1946 taxation year 16% of the total tax payable.

TABLE E - 5

INDIVIDUAL GRADUATED RATES, 1917 - 1952.

(Taxation Years 1947 - 1948).

Brackets: Taxable Income over	not over	Rates for Taxation Year 1947	1948
$ 000	$ 000	%	%
	.1	16	10
.1	.2	17	12
.2	.25	18	14
.25	.3	19	14
.3	.4	20	16
.4	.5	21	18
.5	1	22	20
1	2.5	24	20
2.5	3.5	25	20
3.5	4.5	26	22
4.5	5	28	22
5	6.5	30	26
6.5	8.5	34	30
8.5	10.5	38	35
10.5	11.5	40	35
11.5	13	43	40
13	14	45	40
14	17	47	45
17	18	50	50
18	25	52	50
25	30	55	55
30	50	57	55
50	70	62	60
70	75	65	60
75	100	67	65
100	150	72	70
150	250	77	75
250		82	80

TABLE E- 6

INDIVIDUAL GRADUATES RATES, 1917 - 1952

(Taxation Years 1949 - 1952,)

Brackets: Taxable Income over	not over	Rates for taxation year 1949-51	1952
$ 000	$ 000	%	%
-	1	15	17.5
1	2	17	19.7[a]
2	4	19	22.4
4	6	22	25.7
6	8	26	30.6
8	10	30	35.5
10	12	35	41
12	15	40	46.5
15	25	45	52
25	35	50	57.5
35	40	50	60
40	50	55	63
50	60	55	65.5
60	75	60	68.5
75	90	60	71
90	100	65	74
100	125	65	76.5
125	150	70	79.5
150	225	70	82
225	250	75	85
250	400	75	88
400	-	80	91

a. Including old age security tax, (1% or $ 30.).

TABLE F

PERSONAL EXEMPTIONS FOR INDIVIDUAL INCOME TAX,

1917 - 1953.

Taxation Year	Single Person	Married Person	Dependent	
	$	$	$	
1917	1,500	3,000	nil	(Enacted 1917).
1918-24	1,000	2,000	200	In 1923 the allowance for dependent was raised to $300. and in 1924 to $ 500. (Personal exemptions enacted in 1918).
1925-30	1,500	3,000	500	(Enacted in 1926).
1931	1,200	2,400	500	(Enacted in 1932).
1932-39	1,000	2,000	400	(Enacted in the session of 1932-33).
1940	750	1,500	400	-for purposes of the graduated tax.
	600	1,200	28	-for purposes of National Defence Tax. (Allowance for dependents deductible from tax payable).
1941	750 660	1,500 1,200	400 28	- as above.
1942-46	660	660		- for both normal and graduated tax.
			150	- for dependent wife.
			80	- for each dependent.
			20%	- of amount expended for support of a partial dependent.
			28	- for each dependent deductible from normal tax only.
1946-48	750	1,500	100	- for dependent eligible for family allowance;
			300	- for other dependents.
1949-53	1,000	2,000	150	- for dependent eligible for family allowance;
			400	- for other dependents.
	500	500		- in addition to basic exemption for persons over 65 yrs of age.
		250		- in addition in case of employed wife earning over $ 1,000.

TABLE G

THE INCOME TAX ACT - NORMAL RATES, 1917 -1953.

Taxation year	Rate	
	%	
1917	4	
1918	2	- on income over $ 1,000 but not over $ 1,500, and over $ 2,000 but not over $ 3,000 of single and married persons respectively.
	4	on income exceeding $ 1,500 (single person) and $ 3,000 (married person).
1919-24	4	- on income over $ 1,000 but not over $ 6,000 and over $ 2,000 but not over $ 6,000 of single and married person respectively.
	8	- on income exceeding $ 6,000.
1924-39	nil	
1940	2	- on income between $ 600 -$1,200 of single persons, and over $ 1,200 of married persons.
	3	- on income over $ 1,200 of single persons.
1941	5 7	- as above.
1942-46		Single persons:
	7	on income between $ 660 - $ 1,800
	8	on income between $ 1,800 - $ 3,000
	9	on income exceeding $ 3,000.
		Married persons:
	7	on income exceeding $ 1,200.
1946-53	nil	

TABLE H

SUMMARY OF RATES AND EXEMTIONS FOR FEDERAL CORPORATION INCOME TAX,1917 - 1953.

Taxation year	Income exempt $	Rate of tax %	
1917	3,000	4	
1918	3,000	6	
1919	2,000	10	-when taxable income was less than $ 5,000
'		10.5	-when taxable income was over $ 5,000 (5% surtax was added in 1920 effective 1919).
1924			
1925	2,000	10	In 1926 the 5% surtax was repealed effective 1925.
1926	2,000	8.1	The effective rate was 9% but in 1927 it was reduced by 10%.
1927	2,000	8	Adopted in 1928.
1930	2,000	10	Adopted in 1931.
1931	2,000	11	- when taxable income was over $ 2,000 but nor over $ 5,000.
		11.55	- when taxable income was over $ 5,000. (In 1932 the old 5% surtax was reintroduced, effective 1931.)
1932	nil	12½	- on not consolidated returns;
		13½	- on consolidated returns; (Adopted in 1933).
1934	nil	13½	
		15	- on consolidated returns. Adopted in 1935.
1935	nil	15	
'		17	- on consolidated returns. (Enacted in 1936).
1939			
1940	nil	18	
'		20	- on consolidated returns. (Enacted in 1939).
1946			

TABLE H (Continued)

SUMMARY OF RATES AND EXEMTIONS FOR FEDERAL CORPORATION INCOME TAX , 1917 - 1953.

Taxation year	Income exempt	Rate of tax	
	$	%	
1946	nil	30	
'		32	- on consolidated returns (Enacted 1946).
1947			
1949	nil	10 [a]	- on the first $ 10,000
'		33	- on taxable income exceeding $ 10,000
1950		2	- on consolidated returns in addition to above mentioned rate.
1951	nil	15	- on the first 10,000
		45.6	- on taxable income exceeding $ 10,0000.
		2	for consolidated returns.
1952	nil	20 [b]	- on the first $ 10,000
		50	- on taxable income in excess of $ 10,000. (The right to file consolidated returns was repealed effective January 1,1952.
1953	nil	18	- on the first $ 20,000
		47	- on taxable income exceeding $ 20,000.

a. The lower rate applied to one of a group of related companies.

b. Effective 1952 corporations pay 2% old age security tax.

TABLE 1

NATIONAL INCOME, PERSONAL INCOME, PERSONAL DISPOSABLE INCOME, PERSONAL EXPENDITURES AND SAVINGS, 1926 - 1950.

($ 000,000)

Year	National Income	Personal Income	Personal Dispos-able Income	Personal Expendi-ture	Personal Saving
	$	$	$	$	$
1926	4,185	4,092	4,039	3,687	352
1927	4,417	4,305	4,246	3,919	327
1928	4,832	4,618	4,559	4,194	365
1929	4,789	4,657	4,589	4,393	196
1930	4,238	4,363	4,292	4,204	88
1931	3,333	3,692	3,629	3,646	-17
1932	2,630	3,065	3,001	3,108	-107
1933	2,452	2,843	2,774	2,887	-113
1934	2,897	3,153	3,089	3,077	12
1935	3,188	3,337	3,293	3,243	50
1936	3,487	3,577	3,482	3,457	25
1937	4,062	4,042	3,930	3,777	153
1938	4,018	4,090	3,975	3,815	160
1939	4,373	4,320	4,280	3,904	304
1940	5,263	4,947	4,808	4,399	409
1941	6,563	5,896	5,600	5,053	547
1942	8,337	7,475	6,980	5,514	1,466
1943	9,043	8,176	7,478	5,720	1,751
1944	9,826	9,002	8,164	6,187	1,977
1945	9,840	9,239	8,430	6,811	1,619
1946	9,821	9,761	8,965	7,977	988
1947	10,985	10,390	9,599	9,173	426
1948	12,560	11,943	11,121	10,112	1,009
1949	13,194	12,757	11,968	10,963	1,005
1950	14,406	13,417	12,682	11,862	820

Source : DBS, National Accounts, Income and Expenditure 1926 - 1950.

TABLE J

NATIONAL INCOME - SOME COMPONENTS OF BUSINESS OPERATING ACCOUNT, 1926 - 1950.

($ 000,000)

Year	Corporation before Taxes	Profits after Taxes	Dividends paid to Non-Residents	Dividends paid to Canadians	Undistributed Profits
	$	$	$	$	$
1926	403	369	95	91	179
1927	456	418	106	91	217
1928	530	485	115	102	263
1929	530	482	158	108	211
1930	315	275	177	95	-
1931	159	126	150	93	119
1932	119	15	130	25	172
1933	128	91	98	68	77
1934	287	235	104	82	47
1935	338	274	120	82	68
1936	465	382	161	78	139
1937	590	489	166	100	218
1938	499	405	175	118	108
1939	689	574	177	119	272
1940	836	509	182	157	163
1941	1,108	598	168	147	273
1942	1,292	663	170	126	355
1943	1,267	627	156	139	320
1944	1,221	623	153	118	341
1945	1,226	627	138	128	349
1946	1,455	801	205	173	411
1947	1,800	1,099	248	215	619
1948	1,955	1,270	249	211	788
1949	1,906	1,175	317	228	607
1950	2,300	1,399	404	244	726

Source : DBS, National Accounts, Income and Expenditures, 1926 - 50.

TABLE K

STATUTES OF CANADA, ACTS PERTAINING TO THE INCOME TAX, 1917 - 1953.

1917 ,	c.	28		
1918 ,	c.	25		
1919 ,	c.	55		
1920 ,	c.	49		
1921 ,	c.	33		
1922 ,	c.	25		
1923 ,	c.	52		
1924 ,	c.	46 ,	(37)	
1925 ,	c.	46		
1926 ,	c.	10		
1927 ,	c.	31 ,	(34)	R.S.C. c. 97
1928 ,	c.	12,	30	
1930 ,	c.	24		
1931 ,	c.	35		
1932 ,	c.	34 ,	44	
1932-33 ,	c.	14 ,	15	
1934 ,	c.	19 ,	55	
1935 ,	c.	22 ,	40	
1936 ,	c.	6 ,	38	
1938 ,	c.	48		
1939 ,	c.	46		
1939 ,	c.	6	(2 sess.)	
1940 ,	c.	34		
1940-41 ,	c.	18		
1942-43 ,	c.	28		
1943-44 ,	c.	14		
1944-45 ,	c.	43		
1945 ,	c.	23	(2 sess.)	
1946 ,	c.	55		
1947 ,	c.	63		
1947-48 ,	c.	52 ,	53	
1949 ,	c.	25	(2 sess.)	
1950 ,	c.	40		
1951 ,	c.	51		
1952 ,	c.	29		
1952-53 ,	c.	40		